# SUPREME COURT OF THE UNITED STATES

## OCTOBER TERM, 1939

# No. 417

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NEW WORLD LIFE INSURANCE COMPANY,
PETITIONER,

*vs.*

THE UNITED STATES

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ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

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[fol. 1]

**IN COURT OF CLAIMS OF THE UNITED STATES**

No. 43549

NEW WORLD LIFE INSURANCE COMPANY, a Corporation,

vs.

THE UNITED STATES

1. PETITION—Filed April 29, 1937

To the Honorable, the Chief Justice and the Judges of the Court of Claims of the United States:

The claimant, the New World Life Insurance Company, represents and alleges as follows:

That claimant is a corporation organized and existing under the laws of the State of Washington, having its principal place of business and correct post office address in the City of Seattle, and is engaged in the business of selling life insurance policies or contracts.

Count I

(1) That on or about the 21st day of February, 1930, and in accordance with the provisions of the Revenue Act of 1928, claimant filed with the Collector of Internal Revenue (hereinafter referred to as collector) in and for the District [fol. 2] of Washington its income tax return for the calendar year 1929, in which its net income subject to tax for said year was reported as $50,622.99, and an income tax was shown to be due thereon in the sum of $5,568.53.

(2) That the income tax shown to be due on claimant's said return was paid to said Collector on the dates and in the amounts as follows, to wit:

| Date | Amount |
|---|---|
| Feb. 25, 1930 | $1,392.14 |
| June 12, 1930 | 4,176.39 |

(3) That subsequent thereto the Commissioner of Internal Revenue (hereinafter referred to as Commissioner) through his duly authorized representatives made an ex-

amination of said return, and as a result thereof the Commissioner on October 9, 1931 redetermined the claimant's net income for said year 1929 to be $63,430.42, and on or about March 11, 1932 assessed against the claimant an additional tax thereon for said year in the amount of $1,408.82; that said additional tax of $1,408.82, together with interest thereon in the amount of $166.41, was paid under protest by the claimant to said Collector on or about March 21, 1932.

(4) That among other deductions taken by claimant in its said return for 1929, claimant deducted as investment expenses the amount of $51,134.56; that on the examination of claimant's said return, as aforesaid, the Commissioner disallowed as a deduction, $17,149.92 of said investment expenses of $51,134.56 deducted by the claimant; that the Commissioner allowed a deduction of $4,745.65 for investment expenses, representing traveling expenses incurred and paid by claimant in connection with its investments for the year 1929 which said amount of $4,745.68 claimant did not deduct in its return for said year; that the Commissioner disallowed other deductions for said year, viz.: [fol. 3] $1,828.68, representing 4 per cent of the mean of reserve funds, and $2,993.30, representing depreciation; that the Commissioner excluded from the net income reported by claimant in its said return the sum of $4,418.82, representing exempt interest; that said adjustments resulted in the Commissioner's increasing claimant's net income for said year 1929 from $50,622.99 to $63,430.42, as aforesaid.

(5) That on or about the 22nd day of April, 1933, and in accordance with the provisions of law in that regard and the Regulations of the Secretary of the Treasury promulgated in pursuance thereof, claimant duly filed with said Collector a claim for refund of income taxes overpaid for said year 1929 in the amount of $1,894.89, together with interest thereon, basing said claim upon the ground that the Commissioner in redetermining the taxable net income of the claimant for said year failed to allow as deductions from gross income the following items:

Investment expenses amounting to $17,149.92 within the meaning of Section 203 (a) (5) of the Revenue Act of 1928;

Depreciation in the amount of $2,993.30 within the meaning of Section 203 (a) (7) of the Revenue Act of 1928;

4% of the mean of reserve funds in the amount of $1,828.68 within the meaning of Section 203 (a) (2) of Revenue Act of 1928.

(6) That the Commissioner rejected the claimant's said claim for refund in its entirety, and notified the claimant of such rejection by registered mail on October 25, 1935.

(7) That the correct taxable net income of claimant for said year 1929 was $46,280.50, computed by deducting from the net income of $63,430.42, as redetermined by the Com- [fol. 4] missioner, $17,149.92 representing investment expenses within the meaning of Section 203 (a) (5) of the Revenue Act of 1928, which the Commissioner illegally disallowed; that the correct income tax payable by claimant for said year 1929 was $5,090.86; that the assessment and collection of an income tax for said year 1929 in excess of $5,090.86 was illegal and void; that the amount of income tax overpaid by the claimant for said year 1929 was $1,886.49; that the amount of interest overpaid by the claimant on said additional assessment of income taxes amounting to $1,408.82 for said year 1929 was $166.41; that the refund of $477.67 of said overpayment of $1,886.49 was barred by the statute of limitations; that the Commissioner's action in failing and refusing to allow claimant's said claim for refund in the amount of $1,575.23 (comprised of said overpayment of income taxes of $1,408.82 and said overpayment of interest of $166.41) together with interest on said amounts at the rate of 6 per cent per annum from the date of payment thereof was illegal and without any warrant or authority in law; that there is now justly due and owing to the claimant by the United States the sum of $1,575.23 with interest at the rate of 6 per cent per annum computed from the date of payment, viz., March 20, 1932; and that claimant is justly entitled to recover said amounts from the United States after allowing all just credits and offsets.

(8) That no action upon claimant's foregoing application for refund has been had before Congress or either House thereof, or any of the departments of the Government other than the Treasury Department, or in any other Court; that claimant has fully set forth in its petition the claim and the action thereon by the Treasury Department; that claimant is the sole owner thereof, and the only party interested

[fol. 5] therein, and that no assignment or transfer of the said claim or any part thereof, or any interest therein has been made; that claimant has at all times borne true faith and allegiance to the Government of the United States and has not in any way aided, abetted or given any encouragement or comfort to any persons or government in rebellion against the Government of the United States or at any time aided or abetted or in any way given comfort to any sovereign or government that is or ever has been at war with the United States.

Wherefore, claimant prays for judgment against the United States on its first cause of action for the sum of $1,575.23 with interest at the rate of 6 per cent computed from the respective dates of payment of said sum as follows:

From March 21, 1932, on $1,408.82, taxes overpaid on said date;

From March 21, 1932, on $166.41, interest overpaid on said date;

and for such other and further relief as to this Court may deem just and equitable in the premises.

Count II

(1) That on or about the 7th day of February, 1931, and in accordance with the provisions of the Revenue Act of 1928, claimant filed with the Collector of Internal Revenue (hereinafter referred to as Collector) in and for the District of Washington its income tax return for the calendar year 1930 in which its net income subject to tax for said year was reported as $59,839.94, and an income tax was shown to be due thereon in the sum of $7,180.79.

(2) That the income tax shown to be due on claimant's [fol. 6] said return was paid to said Collector on the dates and in the amounts as follows, to wit:

| Date | Amount |
|---|---|
| Feb. 11, 1931 | $1,795.20 |
| June 11, 1931 | 1,795.20 |
| Aug. 29, 1931 | 1,795.20 |
| Dec. 1, 1931 | 1,795.19 |

(3) That subsequent thereto the Commissioner of Internal Revenue (hereinafter referred to as Commissioner) through his duly authorized representatives made an examination of said return, and as a result thereof, the Commissioner, on January 20, 1933 redetermined the claimant's

net income for said year 1930 to be $85,805.70, and on or about April 12, 1933 assessed against the claimant an additional tax thereon for said year 1930 in the amount of $3,115.89; that said additional tax of $3,115.89, together with interest thereon in the amount of $386.20, was paid under protest by the claimant to said Collector on or about April 22, 1933.

(4) That among other deductions taken by claimant in its said return for 1930, claimant deducted as investment expenses the amount of $62,690.06; that on the examination of claimant's said return, as aforesaid, the Commissioner disallowed as a deduction $21,492.21 of said investment expenses of $62,690.06 deducted by the claimant; that the Commissioner also disallowed other deductions for said year, viz.: $1,799.58, representing 4 per cent of the mean of reserve funds and $3,348.97, representing depreciation; that the Commissioner excluded from the net income reported by claimant in its return the sum of $675.00 representing exempt interest; that said adjustments resulted in the Commissioner's increasing claimant's net income for said year from $59,839.94 to $85,805.70, as aforesaid.

(5) That on or about the 22nd day of April, 1933 and in [fol. 7] accordance with the provisions of law in that regard and the Regulations of the Secretary of the Treasury promulgated in pursuance thereof, claimant duly filed with said Collector a claim for refund of income taxes overpaid for said year 1930 in the amount of $3,196.89 together with interest thereon, basing said claim upon the ground that the Commissioner in redetermining the taxable net income of the claimant for said year failed to allow as deductions from gross income the following items:

Investment expenses amounting to $21,492.21 within the meaning of Section 203 (a) (5) of the Revenue Act of 1928;

Depreciation amounting to $3,348.97 within the meaning of Section 203 (a) (7) of the Revenue Act of 1928;

4% of the mean of reserve funds in the amount of $1,799.58 within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

(6) That the Commissioner rejected the claimant's said claim for refund in its entirety, and notified the claimant of such rejection by registered mail on October 25, 1935.

(7) That the correct taxable net income of claimant for said year 1930 was $64,313.49, computed by deducting from the net income of $85,805.70 as redetermined by the Commissioner, $21,492.21 representing investment expenses within the meaning of Section 203 (a) (5) of the Revenue Act of 1928, which the Commissioner illegally disallowed; that the correct income tax payable by claimant for said year 1930 was $7,717.62; that the assessment and collection of an income tax for said year 1930 in excess of $7,717.62 was illegal and void; that the amount of income tax overpaid by the claimant for said year 1930 was $2,579.06; that [fol. 8] the amount of interest overpaid by the claimant on said additional assessment of income taxes amounting to $3,115.89 for said year 1930 was $325.60; that the Commissioner's action in failing and refusing to allow claimant's said claim for refund in the amount of $2,904.66 (comprised of said overpayment of income taxes of $2,579.06 and said overpayment of interest of $325.60) together with interest on said amounts at the rate of 6 per cent per annum from the respective dates of payment thereof was illegal and without any warrant or authority in law; that there is now justly due and owing to the claimant by the United States the sum of $2,904.66 with interest at the rate of 6 per cent per annum, computed from the respective dates of payment of said sum of $2,904.66 as follows:

From April 22, 1932 on $2,579.06 taxes overpaid on said date;

From April 22, 1932 on $325.60 interest overpaid on said date;

and that claimant is justly entitled to recover said amount from the United States after allowing all just credits and offsets.

(8) That no action upon claimant's foregoing application for refund has been had before Congress or either House thereof, or any of the departments of the Government other than the Treasury Department, or in any other Court; that claimant has fully set forth in its petition the claim and the action thereon by the Treasury Department; that claimant is the sole owner thereof, and the only party interested therein, and that no assignment or transfer of the said claim or any part thereof, or any interest therein has been made; that claimant has at all times borne true

faith and allegiance to the Government of the United States and has not in any way aided, abetted or given any encouragement or comfort to any persons or government in rebel-
[fol. 9] lion against the Government of the United States or at any time aided or abetted or in any way given comfort to any sovereign or government that is or ever has been at war with the United States.

Wherefore, claimant prays for judgment against the United States on its second cause of action for the sum of $2,904.66 with interest at the rate of 6 per cent computed from the respective dates of payment of said sum as follows:

From April 22, 1932 on $2,579.06 taxes overpaid on said date;
From April 22, 1932 on $325.60 interest overpaid on said date;

and for such other and further relief as to this Court may seem just and equitable in the premises.

Count III

(1) That on or about the 6th day of March, 1932, and in accordance with the provisions of the Revenue Act of 1928, claimant filed with the Collector of Internal Revenue (hereinafter referred to as Collector) in and for the District of Washington its income tax return for the calendar year 1931 in which its net income subject to tax for said year was reported as $34,927.40, and an income tax was shown to be due thereon in the sum of $4,191.29.

(2) That the income tax shown to be due on claimant's said return was paid to said Collector on the dates and in the amounts as follows, to wit:

| Date | Amount |
|---|---|
| March 7, 1932 | $1,047.83 |
| June 14, 1932 | 1,047.83 |
| Sept. 14, 1932 | 1,047.83 |
| Dec. 14, 1932 | 1,047.80 |

[fol. 10] (3) That subsequent thereto the Commissioner of Internal Revenue (hereinafter referred to as Commissioner) through his duly authorized representatives made an examination of said return, and as a result thereof the

Commissioner on July 18, 1933 redetermined the claimant's net income to be $66,222.71, and on or about October 1, 1933 assessed against the claimant an additional tax thereon for said year 1931 in the amount of $3,755.44; that said additional tax on $3,755.44, together with interest thereon in the amount of $347.25, was paid under protest by the claimant to said Collector on or about October 11, 1933.

(4) That among other deductions taken by claimant in its said return, claimant deducted as investment expenses the amount of $64,943.14; that on the examination of claimant's said return as aforesaid, the Commissioner disallowed as a deduction $24,124.61 of said investment expenses of $64,943.14 deducted by the claimant; that the Commissioner allowed a deduction of $3,923.11 for investment expenses, which claimant in its return deducted as other real estate expenses; that the Commissioner disallowed said amount of $3,923.11 as a deduction for other real estate expenses; that the Commissioner also disallowed other deductions for said year, viz., $1,759.99 representing 4 per cent of the mean of reserve funds and $4,275.00, representing depreciation; that the Commissioner excluded from the net income reported by claimant in its return the sum of $4.00 representing dividends of domestic corporations; that said adjustments resulted in the Commissioner's increasing claimant's net income for said year from $34,927.40, the amount reported by claimant, to $66,222.71 as aforesaid.

(5) That on or about the 12th day of October, 1933 and in accordance with the provisions of law and the Regula- [fol. 11] tions of the Secretary of the Treasury promulgated in pursuance thereof, the claimant duly filed with said Collector a claim for refund of income taxes overpaid for said year 1931 in the amount of $3,619.16 together with interest thereon, basing said claim upon the ground that the Commissioner in redetermining the taxable net income of the claimant for said year failed to allow as deduction from gross income the following items:

Investment expenses in the amount of $24,124.61 within the meaning of Section 203 (a) (5) of the Revenue Act of 1928.

Depreciation in the amount of $4,275.10 within the meaning of Section 203 (a) (7) of the Revenue Act of 1928.

4% of the mean of reserve funds in the amount of $1,759.99 within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

(6) That on or about the 9th day of October, 1935, in accordance with the provisions of law in that regard and the Regulations of the Secretary of Treasury promulgated in pursuance thereof, claimant duly filed with said Collector a second claim for refund of income taxes overpaid for said year 1931 in the amount of $1,333.24 together with interest thereon, basing said claim upon the ground that the Commissioner in redetermining the taxable net income of the claimant for said year failed to allow any deduction from gross income for depreciation in the amount of $11,-110.36, which claimant sustained on farm buildings during the taxable year 1931, within the meaning of Section 203 (a) (7) of the Revenue Act of 1928.

(7) That the Commissioner rejected the claimant's said claim for refund of $3,619.16 in its entirety, and notified the [fol. 12] claimant of such rejection by registered mail on October 25, 1935; that the Commissioner rejected the claimant's said claim for refund of $1,333.24 in its entirety, and notified claimant of such rejection by registered mail on January 19, 1937.

(8) That the correct taxable net income of claimant for the calendar year 1931 was $36,422.84, computed by deducting from the net income of $66,222.71, as redetermined by the Commissioner, $24,124.61 representing investment expenses within the meaning of Section 203(a) (5) of the Revenue Act of 1928, which the Commissioner illegally disallowed, depreciation of $3,675.26 sustained by the claimant on farm buildings within the meaning of Section 203 (a) (7) of the Revenue Act of 1928, which the Commissioner illegally disallowed, and $2,000.00 representing nontaxable income within the meaning of Section 22 (b) (4) of the Revenue Act of 1928, which the Commissioner illegally included in claimant's taxable net income; that the correct income tax payable by claimant for said year 1931 was $4,370.74; that the assessment and collection of an income tax for said year 1931 in excess of $4,370.74 was illegal and void; that the amount of income tax overpaid by the claimant for said year 1931 was $3,575.99; that the amount of interest overpaid by the claimant on said additional assessment of income taxes amounting to $3,755.44 for said

year 1931 was $330.78; that the Commissioner's action in failing and refusing to allow claimant's said claims for refund in the total amount of $3,906.77 (comprised of said overpayment of income taxes of $3,575.99 and said overpayment of interest of $330.78) together with interest on said amounts at the rate of 6 per cent per annum from the respective dates of payment thereof, was illegal and without [fol. 13] any warrant or authority in law; that there is now justly due and owing to the claimant by the United States the sum of $3,906.77 with interest at the rate of 6 per cent per annum computed from the respective dates of payment of said sum of $3,906.77 as follows:

From October 11, 1933 on $3,575.99 taxes overpaid on said date;
From October 11, 1933 on $330.78 interest overpaid on said date;

and that claimant is justly entitled to recover said amounts from the United States after allowing all just credits and offsets.

(9) That no action upon claimant's foregoing applications for refund has been had before Congress or either House thereof, or any of the departments of the Government other than the Treasury Department, or in any other Court; that claimant has fully set forth in its petition the claims and the action thereon by the Treasury Department; that claimant is the sole owner thereof, and the only party interested therein, and that no assignment or transfer of the said claim or any part thereof, or any interest therein has been made; that claimant has at all times borne true faith and allegiance to the Government of the United States and has not in any way aided, abetted or given any encouragement or comfort to any persons or government in rebellion against the Government of the United States or at any time aided or abetted or in any way given comfort to any sovereign or government that is or ever has been at war with the United States.

Wherefore, claimant prays for judgment against the United States on its third cause of action for the sum of $3,906.77 with interest at the rate of 6 per cent per annum [fol. 14] computed from the respective dates of payment of said sum of $3,906.77 as follows:

From October 11, 1933 on $3,575.99 taxes overpaid on said date;

From October 11, 1933 on $330.78 interest overpaid on said date;

and for such other and further relief as to this Court may seem just and equitable in the premises.

Count IV

(1) That on or about the 15th day of March, 1933, and in accordance with the provisions of the Revenue Act of 1932, claimant filed with the Collector of Internal Revenue (hereinafter referred to as Collector) in and for the District of Washington its income tax return for the calendar year 1932 in which its net income subject to tax for said year was reported as $10,256.82, and an income tax was shown to be due thereon in the sum of $1,410.31.

(2) That the income tax shown to be due on claimant's said return was paid to said Collector on the dates and in the amounts as follows, to wit:

| Date | Amount |
|---|---|
| March 15, 1933 | $352.58 |
| June 10, 1933 | 352.58 |
| September 8, 1933 | 352.58 |
| November 29, 1933 | 352.57 |

(3) That subsequent thereto the Commissioner of Internal Revenue (hereinafter referred to as Commissioner) through his duly authorized representatives made an examination of said return, and as a result thereof the Commissioner on December 12, 1934 redetermined the claimant's net income for said year 1932 to be $43,998.62, and on or about January 16, 1935 assessed against the claimant an additional tax thereon for the calendar year 1932 in the [fol. 15] amount of $744.17; that said additional tax of $744.17, together with interest thereon in the amount of $81.43 was paid under protest by the claimant to said Collector on or about January 18, 1935; that on or about February 6, 1935, the Commissioner assessed against the claimant an additional tax thereon for the calendar year 1932 in the amount of $30.00; that said additional tax of $30.00 together with interest thereon in the amount of $3.28 was

paid under protest by the claimant to said Collector on or about February 8, 1935; that on or about June 12, 1935, the Commissioner assessed against the claimant an additional tax thereon for said year in the amount of $3,865.33; that said additional tax of $3,865.33, together with interest thereon in the amount of $521.55, was paid under protest by the claimant to said Collector on or about June 22, 1935.

(4) That among other deductions taken by claimant in its said return for 1932, claimant deducted as investment expenses the amount of $63,502.01; that on the examination of claimant's said return as aforesaid, the Commissioner disallowed as a deduction $26,634.31 of said investment expenses of $63,502.01 deducted by the claimant; that the Commissioner allowed a deduction of $4,850.75 for investment expenses which claimant in its return deducted as other real estate expenses; that the Commissioner disallowed said amount of $4,850.75 as a deduction for other real estate expenses; that the Commissioner also disallowed other deductions for said year, viz., $1,463.00, representing 4 per cent of the mean of reserve funds and $5,630.36 representing depreciation; that the Commissioner reduced the exempt interest reported by claimant in its said return in the amount of $14.13, and added said amount to the claimant's taxable net income for said year; that said adjustments [fol. 16] resulted in the Commissioner's increasing claimant's net income for said year from $10,256.82 to $43,998.62 as aforesaid.

(5) That on or about the 22nd day of June, 1935 and in accordance with the provisions of law in that regard and the Regulations of the Secretary of Treasury promulgated in pursuance thereof, claimant duly filed with said Collector a claim for refund of income taxes overpaid for said year 1932 in the amount of $3,662.22 together with interest, basing said claim upon the ground that the Commissioner in redetermining the taxable net income of the claimant for said year failed to allow as a deduction from gross income investment expenses in the amount of $26,634.31, within the meaning of Section 203(a)(5) of the Revenue Act of 1932.

(6) That on or about the 29th day of October, 1935, in accordance with the provisions of law in that regard and the Regulations of the Secretary of Treasury promulgated in pursuance thereof, claimant duly filed with said Collector

a second claim for refund of income taxes overpaid for said year 1932 in the amount of $1,728.62 together with interest thereon, basing said claim upon the ground that the Commissioner in redetermining the taxable net income of the claimant for said year failed to allow any deduction from gross income for depreciation in the amount of $12,571.82, which claimant sustained on farm buildings during the taxable year 1932, within the meaning of Section 203(a)(7) of the Revenue Act of 1932.

(7) That the Commissioner rejected the claimant's said claim for refund of $3,662.22 in its entirety, and notified the claimant of such rejection by registered mail on November 26, 1935; that the Commissioner rejected the claimant's said claim for refund of $1,728.62 in its entirety and notified [fol. 17] claimant of such rejection by registered mail on January 19, 1937.

(8) That the correct taxable net income of claimant for the calendar year 1932 was $10,453.95 computed by deducting from the net income of $43,998.62, as determined by the Commissioner, $26,634.31 representing investment expenses which the Commissioner illegally disallowed, depreciation of $5,272.06 sustained by claimant on farm buildings which the Commissioner illegally disallowed, and $1,638.30 representing interest paid by claimant on supplementary contracts not involving life contingencies which the Commissioner illegally disallowed; that the correct income tax payable by claimant for said year 1932 was $1,437.42; that the assessment and collection of an income tax for said year 1932 in excess of $1,437.42 was illegal and void; that the amount of income tax overpaid by the claimant for said year 1932 was $4,612.39; that the amount of interest overpaid by the claimant on said additional assessment of income taxes amounting to $4,639.50 for said year 1932 was $604.88; that the Commissioner's action in failing and refusing to allow petitioner's said claims for refund in the total amount of $5,217.27 (comprised of said overpayment of income taxes of $4,612.39 and said overpayment of interest of $604.88) together with interest on said amount at the rate of 6 per cent per annum from the respective dates of payment thereof, was illegal and without any warrant or authority in law; that there is now justly due and owing to the claimant by the United States the sum of $5,217.27 with interest

at the rate of 6 per cent per annum computed from the respective dates of payment of said sum of $5,217.27 as follows:

From January 18, 1935 on $717.06 taxes overpaid on said date;
[fol. 18] From January 18, 1935 on $79.95 interest overpaid on said date;
From February 8, 1935 on $30.00 taxes overpaid on said date;
From February 8, 1935 on $3.28 interest overpaid on said date;
From June 22, 1935 on $3,865.33 taxes overpaid on said date;
From June 22, 1935 on $521.55 interest overpaid on said date;

that claimant is justly entitled to recover said amount from the United States after allowing all just credits and offsets.

(9) That no action upon claimant's foregoing application for refund has been had before Congress or either House thereof, or any of the departments of the Government other than the Treasury Department, or in any other Court; that claimant has fully set forth in its petition the claim and the action thereon by the Treasury Department; that claimant is the sole owner thereof, and the only party interested therein, and that no assignment or transfer of the said claim or any part thereof, or any interest therein has been made; that claimant has at all times borne true faith and allegiance to the Government of the United States and has not in any way aided, abetted or given any encouragement or comfort to any persons or government in rebellion against the Government of the United States or at any time aided or abetted or in any way given comfort to any sovereign or government that is or ever has been at war with the United States.

Wherefore, claimant prays for judgment against the United States on its fourth cause of action for the sum of $5,217.27 with interest thereon at the rate of 6 per cent com-
[fol. 19] puted from the respective dates of payment of said sum as follows:

From January 18, 1935 on $717.06 taxes overpaid on said date;

From January 18, 1935 on $79.95 interest overpaid on said date;
From February 8, 1935 on $30.00 taxes overpaid on said date;
From February 8, 1935 on $3.28 interest overpaid on said date;
From June 22, 1935 on $3,865.33 taxes overpaid on said date;
From June 22, 1935 on $521.55 interest overpaid on said date;

and for such other and further relief as to this Court may seem just and equitable in the premises.

Wherefore, and in view of all the above and foregoing, claimant prays for judgment against the defendant on its first cause of action for the sum of, to-wit: $1,575.23 with interest at the rate of 6 per cent per annum, as follows:

From March 21, 1932 on $1,408.82 taxes overpaid on said date;
From March 21, 1932 on $166.41 interest overpaid on said date;

on its second cause of action for the sum of, to-wit: $2,904.66 with interest at the rate of 6 per cent per annum, as follows:

From April 22, 1932 on $2,579.06 taxes overpaid on said date;
From April 22, 1932 on $325.60 interest overpaid on said date;

on its third cause of action for the sum of, to-wit: $3,906.77 with interest at the rate of 6 per cent per annum as follows:

[fol. 20] From October 11, 1933 on $3,575.99 taxes overpaid on said date;
From October 11, 1933 on $330.78 interest overpaid on said date;

on its fourth cause of action for the sum of, to-wit: $5,217.27 with interest at the rate of 6 per cent per annum, as follows:

From January 18, 1935 on $717.06 taxes overpaid on said date;
From January 18, 1935 on $79.95 interest overpaid on said date;

From February 8, 1935 on $30.00 taxes overpaid on said date;

From February 8, 1935 on $3.28 interest overpaid on said date;

From June 22, 1935 on $3,865.33 taxes overpaid on said date;

From June 22, 1935 on $521.55 interest overpaid on said date;

and for such other and further relief as to this Honorable Court may seem just and equitable in the premises.

Walter E. Barton, Counsel for Claimant.

[fol. 21] *Duly sworn to by Russell C. Burton. Jurat omitted in printing.*

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[fol. 22] II. General Traverse—Filed June 8, 1937

And now comes the Attorney General, on behalf of the United States, and answering the petition of the claimant herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

James W. Morris, Assistant Attorney General.

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III. Argument and Submission of Case

On January 9, 1939, argument of the case on merits was begun by Mr. Walter E. Barton, for plaintiff. On January 10, 1939, was heard further for plaintiff. Mr. Guy Patten and Mr. Edward H. Horton, were heard for the defendant, and the case was submitted.

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[fol. 23] IV. **Special Findings of Fact, Conclusion of Law and Opinion of the Court by Littleton, J.**—Filed March 6, 1939

Mr. Walter E. Barton for the plaintiff.

Mr. Guy Patten, with whom was Mr. Assistant Attorney General James W. Morris, for the defendant.

Mr. Fred K. Dyar and Mr. Robert Anderson were on the brief.

Plaintiff seeks to recover $13,603.83, of which $12,176.26 represents alleged overpayments of income tax for 1929 to 1932, inclusive, and $1,427.57 represents alleged overpayment of interest on additional taxes collected for those years.

The two questions presented are (1) whether the apportionment by plaintiff, a life insurance company, to its investment expenses of a percentage of the salaries paid to its general officers and cashiers for services performed and to be performed by them in all departments of its business constitutes an assignment or inclusion of "general expenses in part to investment expenses" within the meaning of section 203 (a) (5) of the Revenue Acts of 1928 and 1932; and (2) whether, in determining the deduction from gross income of the specified percentage of the mean of the reserves at the beginning and end of each taxable year, plaintiff is entitled under sections 201 (a) and 203 (a) (2) of the revenue acts above mentioned to include as a part of the "reserve funds required by law" its reserves for Total [fol. 24] and Permanent Disability Benefits under policies of Health and Accident Insurance for 1929 to 1932.

## Special Findings of Fact

1. Plaintiff is a Stock Life Insurance Company, organized and existing under the laws of the State of Washington with its principal offices in Seattle. During 1929 to 1932, inclusive, and prior thereto, plaintiff was engaged in the business of issuing and selling life insurance in Washington and other states of the United States. It writes non-participating policies of life insurance on the level-premium plan, the mean of the reserve funds of which, held for the fulfillment of such life insurance contracts for the years involved herein, was as follows:

| | |
|---|---|
| 1929 | $6,761,711.16 |
| 1930 | 7,400,545.31 |
| 1931 | 7,892,137.96 |
| 1932 | 8,117,372.90 |

Among the policies of life insurance issued by plaintiff, and which it had outstanding during 1929 to 1932, inclusive, were certain life insurance policies which contained additional provisions for Total and Permanent Disability Benefits and/or Accidental Death Benefits, the mean of the

reserve funds of which, held for the fulfillment of such disability and accidental death benefit contract, was as follows:

| | |
|---|---|
| 1929 | $149,687.89 |
| 1930 | 195,305.12 |
| 1931 | 201,889.46 |
| 1932 | 230,886.50 |

Plaintiff issues separate life policies, but issues no separate policies covering disability benefits and/or accidental death benefits. Its life insurance contracts of combined life, health, and accident insurance constitute all the classes of insurance issued by it.

2. Plaintiff filed income-tax returns for 1929 to 1932, inclusive. Its return for 1929 disclosed a net income of $50,622.99, and a tax of $5,568.53 which it paid in the amounts of $1,392.14 on February 25, 1930, and $4,176.39 [fol. 25] on June 12, 1930. Thereafter the Commissioner of Internal Revenue assessed an additional tax for that year of $1,408.82 which was paid March 21, 1932, together with interest thereon of $166.41.

3. In its return for 1929 plaintiff deducted from gross income as investment expenses the sum of $51,134.56, of which $17,149.92 consisted of the following items:

| | |
|---|---|
| 50% of its president's salary | $9,000.00 |
| 80% of its treasurer's salary | 6,799.92 |
| 75% of its general counsel's salary | 1,350.00 |
| Total | $17,149.92 |

In his final determination for 1929, the Commissioner, among other adjustments,

(a) Allowed plaintiff an additional deduction for investment expenses of $4,745.65, which it had not taken in its return and which is not in dispute in this case;

(b) Disallowed the above items aggregating $17,149.92 as deductions on account of investment expenses, which plaintiff claims it is entitled to in this case;

(c) Allowed a deduction of 4 per centum of the mean of reserves for Total and Permanent Disability Benefits, which the defendant claims are not allowable deductions as re-

serves required by law within the meaning of the Tax Act in the case of a Life Insurance Company. Four percent of the mean of such disability reserves so allowed is:

| | |
|---|---|
| For active lives | $3,142.51 |
| For disabled lives | 2,439.77 |
| Total | $5,582.28 |

4. One-fourth of 1 per centum of the mean of plaintiff's invested assets for 1929 is $21,465.27.

5. Plaintiff's return for 1930 disclosed a net income of $59,839.94, and a tax of $7,180.79 which it paid in three installments of $1,795.20 each on February 11, June 11, and August 29, 1931, and of $1,795.19 on December 1, 1931. Thereafter the Commissioner assessed an additional tax for this year of $3,115.89 which plaintiff paid April 22, 1933, together with interest thereon of $386.20.

[fol. 26] 6. In its return for 1930, plaintiff deducted from gross income as investment expenses the sum of $62,690.06, of which amount $21,492.21 consisted of the following items:

| | |
|---|---|
| 50% of its president's salary | $9,000.00 |
| 80% of its treasurer's salary | 7,899.92 |
| 75% of its general counsel's salary | 1,350.00 |
| 25% of its cashier's salary (Seattle District) | 580.16 |
| 50% of its cashier's salary (Oakland District) | 770.00 |
| 25% of its cashier's salary (Portland District) | 180.00 |
| 50% of its cashier's salary (Los Angeles District) | 1,607.50 |
| 50% of cost of its president's bond<br>80% of cost of its treasurer's bond<br>25% of cost of its cashiers' bonds | 104.63 |
| Total | $21,492.21 |

In his final determination for this year, the Commissioner, among other adjustments,

(a) Disallowed the above items aggregating $21,492.21 as deductions on account of investment expenses, which plaintiff claims it is entitled to in this case;

(b) Allowed a deduction of 4 per centum of the mean of reserves for total and permanent disability benefits, which the defendant claims are not allowable deductions as re-

serves required by law, within the meaning of the Tax Act in the case of a Life Insurance Company. Four percent of the mean of such disability reserves so allowed is:

| | |
|---|---|
| For active lives | $2,634.84 |
| For disabled lives | 3,817.28 |
| Total | $6,452.12 |

7. One-fourth of 1 per centum of the mean of plaintiff's invested assets for 1930 is $23,243.10.

8. Plaintiff's return for 1931 disclosed a net income of $34,927.40, and a tax of $4,191.29, which it paid in three installments of $1,047.83 each on March 7, June 14, and September 14, 1932, and $1,047.80 on December 14, 1932. Thereafter the Commissioner assessed an additional tax for this year of $3,755.44 which plaintiff paid October 11, 1933, together with interest thereon of $347.25.

9. In its return for 1931, plaintiff deducted from gross income, as investment expenses, the sum of $64,943.14, of which $24,124.61 consisted of the following items:

| | |
|---|---|
| [fol. 27] 50% of its president's salary | $9,000.00 |
| 80% of its treasurer's salary | 7,999.92 |
| 75% of its general counsel's salary | 2,193.75 |
| 50% of its cashier's salary (Spokane District) | 1,660.00 |
| 25% of its cashier's salary (Seattle District | 346.32 |
| 50% of its cashier's salary (Oakland District) | 872.50 |
| 25% of its cashier's salary (Portland District) | 332.50 |
| 50% of its cashier's salary (Los Angeles District) | 1,600.00 |
| 50% of cost of its president's bond<br>80% of cost of its treasurer's bond<br>50% of cost of its cashiers' bonds (Oakland, Spokane, Los Angeles, and San Diego Districts)<br>25% of cost of its cashiers' bonds (Seattle, Portland Districts) | 119.62 |
| Total | 24,124.61 |

In his final determination for 1931, the Commissioner, among other adjustments,

(a) Disallowed the above items aggregating $24,124.61 as deductions on account of investment expenses which plaintiff claims it is entitled to in this case:

(b) Disallowed other deductions as follows:

| | |
|---|---|
| (1) 4% of mean of reserves overstated on account of supplementary contracts, disability benefits, and policies upon which a surrender value may be demanded | $7,653.79 |
| (2) Investment expenses on the ground that they were capital expenditures | 3,923.11 |
| (3) Real estate expenses on the ground that they were capital expenditures | 1,005.72 |
| Total | 12,582.62 |

The above disallowed deductions are not in dispute in this case, except that included in the above item of $7,653.79 is an item of $4,937.58 representing four per centum of the mean of reserves held by plaintiff on account of disability benefits, disabled lives, which the Commissioner disallowed as a deduction and which the plaintiff claims it is entitled to in this case.

(c) Allowed a deduction of 4 per centum of the mean of reserves for Total and Permanent Disability Benefits, Active Lives, amounting to $2,743.76, which the defendant claims is not an allowable deduction as reserves required by law within the meaning of the Tax Act in the case of a Life Insurance Company;

[fol. 28] (d) Allowed the following additional deductions from gross income:

| | |
|---|---|
| (1) Depreciation on farm buildings | $3,675.26 |
| (2) Interest paid on supplementary contracts | 2,000.00 |
| Total | 5,675.26 |

The foregoing additional deductions allowed by the Commissioner are not in dispute in this case.

10. One-fourth of 1 per centum of the mean of plaintiff's invested assets for 1931 is $24,513.65.

11. Plaintiff's return for 1932 disclosed a net income of $10,256.82, and a tax of $1,410.31 which it paid in three installments of $352.58 on March 15, June 10, and September 8, 1933, and $352.57 on November 29, 1933. Thereafter the Commissioner assessed additional taxes for this year, which it paid, with interest, as follows:

| | | Interest |
|---|---|---|
| January 18, 1935 | $744.17 | $81.43 |
| February 8, 1935 | 30.00 | 3.28 |
| June 22, 1935 | 3,865.33 | 521.55 |

12. In its return for 1932 plaintiff deducted from gross income as investment expenses the sum of $63,502.01, of which $26,634.31 consisted of the following items:

| | |
|---|---|
| 50% of its president's salary | $9,000.00 |
| 80% of its treasurer's salary | 7,999.92 |
| 75% of its general counsel's salary | 4,214.51 |
| 50% of its cashier's salary (Spokane District) | 1,990.00 |
| 25% of its cashier's salary (Seattle District) | 302.50 |
| 50% of its cashier's salary (Oakland District) | 1,120.00 |
| 25% of its cashier's salary (Portland District) | 332.50 |
| 50% of its cashier's salary (Los Angeles District) | 1,600.00 |
| Total | 26,559.43 |
| 80% of cost of its treasurer's bond<br>50% of cost of its cashiers' bonds (Oakland, Los Angeles, and Spokane Districts)<br>25% of cost of its cashiers' bonds (Seattle and Portland Districts) | 74.88 |
| Grand total | 26,634.31 |

[fol. 29] In his final determination for this year, the Commissioner, among other adjustments,

(a) Disallowed the above items aggregating $26,634.31 as deductions on account of investment expenses, which plaintiff claims it is entitled to in this case;

(b) Disallowed other deductions, as follows:

(1) 3¾ per centum of the mean of reserves overstated on account of supplementary con-

| | |
|---|---|
| tracts, disability benefits, and policies upon which a surrender value may be demanded | $7,546.62 |
| (2) Investment expenses on the ground that they were capital expenditures | 4,850.75 |
| (3) Real estate expenses on the ground that they were capital expenditures | 4,519.76 |
| Total | $16,917.13 |

The above disallowed deductions are not in dispute in this case, except that included in the above item of $7,546.62 is an item of $4,920.24 representing 3¾ per centum of the mean of reserves held by plaintiff on account of Disability Benefits, Disabled Lives, which the Commissioner disallowed as a deduction and which the plaintiff claims it is entitled to in this case.

(c) Allowed a deduction of 3¾ per centum of the mean of reserves for Total and Permanent Disability Benefits, Active Lives, amounting to $3,402.21, which the defendant claims is not an allowable deduction as reserves required by law within the meaning of the Tax Act in the case of a Life Insurance Company;

(d) Allowed the following additional deductions from gross income:

| | |
|---|---|
| (1) Depreciation on farm buildings | $5,272.06 |
| (2) Interest paid on supplementary contracts | 1,638.30 |
| Total | $6,910.36 |

The foregoing additional deductions allowed by the Commissioner are not in dispute in this case.

13. One-fourth of 1 per centum of the mean of plaintiff's invested assets for 1932 is $24,872.81.

14. There are in evidence, as a part of the stipulation of facts, copies of the Commissioner's letters of final determination of plaintiff's tax liabilities for the years 1929 and 1930; also a copy of the Commissioner's letter of final determination of plaintiff's tax liabilities for 1931 and 1932. [fol. 30] These letters of final determination are made a part hereof by reference.

15. November 22, 1929, the Board of Directors of the plaintiff passed the following resolution, which was not modified or rescinded prior to the end of the taxable year 1932:

That in connection with office salaries paid, the Company's disbursements for such purposes during the year 1929 and in succeeding years, until by proper Board Resolution the ratios herein shall be changed, shall be charged as between Investment and Insurance expense in the following proportions:

| Name | Investment | Insurance |
|---|---|---|
| John J. Cadigan (President) | 50% | 50% |
| Edward J. O'Shea (Treasurer) | 80% | 20% |
| Graves, Mizer & Graves (General Counsel) | 75% | 25% |
| R. L. McGinnis | 100% | |
| F. W. Maddux | 100% | |
| Cashier in Seattle Office | 25% | 75% |
| Cashier in Oakland Office | 50% | 50% |
| Cashier in Portland Office | 25% | 75% |
| Cashier in Los Angeles Office | 50% | 50% |
| Cashier in San Diego Office | 25% | 75% |
| All employees in home office Investment Department | 100% | |
| All employees in home office Policy Loan Department | 100% | |

The salaries paid by plaintiff to the officers and cashiers named during the taxable years involved were as follows:

| | 1929. | 1930. | 1931. | 1932. |
|---|---|---|---|---|
| President | $18,000.00 | $18,000.00 | $18,000.00 | $18,000.00 |
| Treasurer | 8,500.00 | 9,875.00 | 10,000.00 | 10,000.00 |
| General Counsel | 1,800.00 | 1,800.00 | 3,112.50 | 5,619.08 |
| Seattle Cashier | | 2,320.64 | 1,325.28 | 1,210.00 |
| Oakland Cashier | | 1,540.00 | 1,750.00 | 2,240.00 |
| Portland Cashier | | 720.00 | 1,330.00 | 1,330.00 |
| Los Angeles Cashier | | 3,215.00 | 3,200.00 | 3,200.00 |
| Spokane Cashier | | | 3,200.00 | 3,980.00 |

The salaries of these officers and cashiers of plaintiff were for all services rendered by them, and the services performed and expected to be performed by such officers and cashiers related to matters in all departments of plaintiff's business, that is, in both the investment and underwriting departments.

[fol. 31] Plaintiff charged to its investment department and deducted as investment expenses in its income tax returns for 1929 to 1932, inclusive, amounts equal to the same percentages of the total salaries paid to its officers and employees, which quoted resolution provided should be charged as investment expenses. The amounts of the deductions are set out in findings 3, 6, 9, and 12.

16. The percentages of the salaries of the officers of plaintiff, which the resolution directed to be charged to the investment department, represent estimates arrived at by such officers based upon a careful consideration of the duties theretofore performed by them and which they estimated would be performed in the future. The respective general officers and employees mentioned in the resolution of November 22, 1929, devoted at least as much of their time to the investment department of the plaintiff's business for the respective years involved herein as the percentages set out in the resolution.

17. The percentages of the salaries of the cashiers, which the resolution directed to be charged to the investment department, represent estimates arrived at by the supervising officers in charge of such cashiers based upon a careful consideration of the duties theretofore performed by the cashiers and which they estimated would be performed in the future. It is stipulated that, if called upon, the respective supervising officers of cashiers would testify under oath that the cashiers devoted at least as much of their time to the investment branch of plaintiff's business for the respective years involved as the percentages set out in the foregoing resolution. There is in evidence as a part of the stipulation of facts a statement showing the cash transactions by plaintiff's branch offices in the underwriting and investment departments, respectively, for 1931 and 1932. This statement is made a part hereof by reference. The approximate percentages of cash transactions relating to the underwriting and investment departments for 1931 and 1932, as shown in this statement, apply to the year 1930.

18. Plaintiff issues various standard forms of life insurance policies, such as Straight Life, Twenty Payment Life, Endowment, etc., some of which also include provisions for [fol. 32] total and permanent disability benefits and accidental death benefits. On each policy covering combined

life, health, and accident insurance, the total premium shown on the face of such policy includes: (1) the premium paid for the life-insurance coverage; (2) the premium paid for the total and permanent disability insurance coverage; and (3) the premium paid for the accident insurance coverage. The premium paid for the total and permanent disability coverage and the premium paid for the accident insurance coverage are stated separately elsewhere in the policy.

The terms of such policy are—

(1) The cancellation or the termination of the life insurance automatically cancels or terminates the disability and/or the accident insurance.

(2) The policyholder may discontinue the disability and/or the accident insurance at any premium-paying date without canceling the life insurance and without affecting the life insurance premium. In such event, the total premium shown on the face of the policy would be reduced by the amount of the premium for disability insurance and/or the amount of the premium for accident insurance specified in the policy.

(3) The disability and accident benefits are not included in any paid-up term insurance, or other paid-up benefits granted upon the surrender or lapse of the policy; nor does any reserve held on account thereof enter into the amount of the reserve held on account of the life insurance covered by the policy, or the surrender, cash, or loan value shown in the "Table of Loan and Nonforfeiture Values."

19. A sample combined life, health, and accident insurance policy issued on May 1, 1932, to John Doe, at age 35, for $1,000, the same being nonparticipating, endowment at age 85, premiums payable for 20 years, and containing total and permanent disability and accidental death benefits, is in evidence as stipulation Exhibit D and is made a part hereof by reference. The total annual premium for the combined life, health, and accident insurance is $36.30 as shown on the first page of said sample policy. The annual premium for total and permanent disability benefits is $4.31, and the annual premium for accidental death benefits is $2.00 as shown on page 6 of such sample policy. Page 6 thereof also [fol. 33] contains the usual provisions pertaining to total and permanent disability benefits and accidental death benefits, respectively.

20. Plaintiff issues its life insurance contracts and its combined life and disability insurance contracts on what is commonly known as the level premium plan; that is, the insured pays during the early years an annual premium in excess of the current cost of such insurance. The excess amount of such premium is devoted to the creation of a reserve, which, with accumulated interest at the assumed rate, enables such insurance to be maintained in later years, when the stipulated level premium would be insufficient to meet the current cost of such insurance on the level premium plan. The plaintiff creates and maintains a reserve out of the premiums received for the life insurance coverage, and also creates and maintains a separate reserve out of the premiums received for the total and permanent disability benefits coverage, as hereinafter referred to.

21. In respect of any policy in force which also provided for disability and/or accidental death benefits, plaintiff at all times set up and maintained a life reserve in the same manner as if the policy had been issued without such disability and/or accidental death provisions. For 1929 to 1932, inclusive, plaintiff's outstanding assurance obligations applicable to life insurance were valued upon the basis of the American Experience Table of Mortality, with interest at 3½ per centum, as required by the laws of the State of Washington, and the rules and regulations of the Insurance Commissioner of said State, and also as required by the laws of other states in which plaintiff did business, and it maintained reserves therefor as thus calculated. Plaintiff deducted 4 per centum of the mean of such reserve funds held by it at the beginning and end of the taxable years 1929, 1930, and 1931, and 3¾ per centum of the mean of such reserves held by it at the beginning and end of the taxable year 1932. The Commissioner allowed these deductions for the respective years above mentioned, and there is no controversy in this suit with respect thereto. Reserves for accidental death benefits are not in controversy in this case.

[fol. 34] 22. In respect of any combined life, health, and accident insurance policies in force, in addition to its reserves with respect to the life insurance coverage, plaintiff for 1929 to 1932, inclusive, set up and maintained, out of the total and permanent disability premiums, reserves with respect to the total and permanent disability benefits covered

by said policies, computed as hereinafter stated, and commonly known as Reserve for Total and Permanent Disability Benefits, Active Lives.

In calculating the amount of the premium charged for such total and permanent disability insurance, the following factors are taken into consideration: (1) the rate of disability, (2) the rate of mortality, (3) the rate of interest, and (4) the rate of expense. The first three, the rate of disability, the rate of mortality, and the rate of interest, determine the amount of the net disability premium.

The net disability premium is that amount which (in connection with a given number of lives) will be exactly sufficient to pay all disability claims of the group, provided deaths take place and disability occurs according to the adopted combined mortality and disability table (usually Hunter's Combined Table of Mortality and Disability) and the net disability premiums are invested immediately at the rate of interest assumed (usually 3 per centum to 3½ per centum compound interest).

The fourth element, namely, expense or loading, is the amount added to the net disability premium necessary to take care of the underwriting expenses of the company, such as agents' commissions, cost of collecting premiums, settlement of disability claims, overhead expenses pertaining to underwriting, etc., with respect to the total and permanent disability coverage in the policies, and which are not reflected in the basic assumptions as to disability, mortality, and interest.

For a given number of lives, each of the same age at the beginning of any year, in determining the rate of disability for the group or for a unit thereof, there must be taken into consideration at least four elements:

1. The number of persons who would be ineligible or incapable of securing disability insurance;

[fol. 35] 2. The number who might obtain disability insurance, but die before becoming totally and permanently disabled;

3. The number who might obtain disability insurance and become totally or permanently disabled and live to receive disability benefits during the entire period of their expectancy;

4. The number who might obtain disability insurance and become totally and permanently disabled but who might die or recover prior to the expiration of their expectancy.

23. For the taxable years 1929 to 1932, inclusive, plaintiff credited to its Reserve for Total and Permanent Disability Benefits, Active Lives, the necessary portion of the net disability premiums charged for disability coverage. This reserve relates to outstanding disability insurance in force on which total and permanent disability has not occurred. The following gives the mean of plaintiff's Reserves for Total and Permanent Disability Benefits, Active Lives, held at the beginning and end of the taxable years involved:

| | |
|---|---|
| 1929 | $78,562.76 |
| 1930 | 65,871.14 |
| 1931 | 68,593.97 |
| 1932 | 90,725.50 |

Plaintiff's Reserve for Total and Permanent Disability Benefits, Active Lives, was computed in accordance with standard combined mortality and disability tables with interest rates as required by the law of the State of Washington and/or by the rules and regulations of the Insurance Commissioner of said State, and also as required by the laws of other states in which plaintiff did business. The plaintiff deducted 4 per centum of the mean of such Reserves for Total and Permanent Diability Benefits, Active Lives, held by it at the beginning and end of the taxable years 1929 to 1931, inclusive, and 3¾ per centum of the mean of such Reserve for Total and Permanent Disability Benefits, Active Lives, held by it at the beginning and end of the taxable year 1932. The amounts of these deductions and the Commissioner's action with respect thereto are referred to in findings 3 (c), 6 (b), 9 (c), and 12 (c), respectively.

[fol. 36] 24. If, as, and when a person carrying disability insurance becomes totally and permanently disabled, plaintiff transfers a certain amount, computed in the manner hereinafter described, from the Reserve for Total and Permanent Disability Benefits, Active Lives, to another reserve commonly called Reserve for Total and Permanent Disability Benefits, Disabled Lives. The amount so transferred is calculated upon the basis of selected tables of probabilities of length of disability and expected benefits (such as Hunter's Disabled Lives Mortality Table), plus an as-

sumed rate of interest (usually 3½ per centum compound interest). The calculation also takes into consideration the mortality element. At the time of the happening of such contingency, it is not possible to determine definitely the amount of the disability benefits which the Company (plaintiff) shall be required to pay. This is due to the indefiniteness of the period during which the Company will be called upon to pay disability benefits, as the disability payments cease upon the death of such disabled person or upon the discontinuance of his disability.

25. The following gives the mean of plaintiff's Reserves for Total and Permanent Disability Benefits, Disabled Lives, held at the beginning and end of the taxable years involved:

| | |
|---|---|
| 1929 | $60,994.28 |
| 1930 | 95,432.05 |
| 1931 | 123,439.49 |
| 1932 | 131,206.50 |

These Reserves for Total and Permanent Disability Benefits, Disabled Lives, were computed in accordance with standard combined mortality and disability tables for disabled lives, with interest rates as required by the law of the State of Washington, and/or the rules and regulations of the Insurance Commissioner of said State, and also as required by the laws of other states in which plaintiff did business and/or the rules and regulations of the Insurance Commissioners of said other states. Plaintiff deducted 4 per centum of the mean of the Reserves for Total and permanent Disability Benefits, Disabled Lives, held by it at the beginning and end of the taxable years 1929 to 1931, inclusive, and 3¾ per centum of the mean of the Reserves for [fol. 37] Total and Permanent Disability Benefits, Disabled Lives, held by it at the beginning and end of the taxable year 1932. The amounts of these deductions and the Commissioner's action with respect thereto are referred to in findings 3 (c), 6 (b), 9 (b), and 12 (b), respectively.

26. April 22, 1933, plaintiff filed its claims for 1929 and 1930, in which it asked for the refund of $1,894.89 and $3,196.89 for these years respectively, together with interest on the ground that it was entitled to the deduction from gross income of the amounts of $17,149.92 and $21,492.21 as investment expenses for the years, respectively,

in the computation of its income tax liabilities. These claims were rejected by the Commissioner on October 25, 1935.

27. October 12, 1933, plaintiff filed its claim in which it asked for the refund of $3,619.16, with interest, for 1931, upon the ground that it was entitled to a deduction from gross income of the amount of $24,124.61 as investment expenses, a deduction on account of depreciation in the amount of $4,275.10, and other deductions not material here.

October 9, 1935, plaintiff filed its claim in which it asked for the refund of $1,333.24 for 1931, with interest, upon the ground that it was entitled to a deduction of $11,110.36 on account of depreciation. The claim for refund for $3,619.16 was rejected October 25, 1935, and the claim for $1,333.24 was rejected January 19, 1937.

28. June 24, 1935, plaintiff filed its claim in which it asked the ground that it was entitled to a deduction from gross income of $26,634.31 as investment expenses.

October 29, 1935, plaintiff filed a claim in which it asked for the refund of $1,728.62, and interest, for 1932, upon the ground that it was entitled to a deduction of $12,571.82 on account of depreciation.

The Commissioner rejected the claim for $3,662.22 on November 26, 1935, and the claim for $1,728.62 on January 19, 1937.

29. In rejecting the refund claims for 1929, 1930, and 1931, the Commissioner held and determined as follows:

With respect to issue (3), that the allocation of salaries and counsel fees made in accordance with a resolution of [fol. 38] the Board of Trustees was a reasonable division of these expenditures; that they became a part of the investment expense, and that the limitation provided in section 203 (a) (5) of the Revenue Act of 1928 does not apply, the Bureau holds that the salaries of the president and treasurer and legal expenses of the company are expenses of a general nature that cover all branches of the business; therefore, an allocation of a portion of this general expense would necessitate the application of the limitation as provided in the section and Act referred to above.

In rejecting plaintiff's claim for refund for 1932, the Commissioner held and determined as follows:

Your claim is based on the contention that the allocation of salaries and counsel fees made in accordance with a resolution of the Board of Trustees was a reasonable division of these expenditures; that they became a part of the investment expense, and that the limitation provided in Section 203 (a) (5) of the Revenue Act of 1932 does not apply.

The Bureau holds that the salaries of the president and treasurer and legal expenses of the company are expenses of a general nature that cover all branches of the business; therefore, an allocation of a portion of this general expense would necessitate the application of the limitation as provided in the Section and Act referred to above.

### Conclusion of Law

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover, and its petition is therefore dismissed.

Judgment is rendered against plaintiff for the cost of printing the record herein, the amount thereof to be entered by the clerk and collected by him according to law.

### Opinion

Littleton, Judge, delivered the opinion of the court:

The first question involves a construction of section 203 (a) (5), Revenue Act of 1928, which relates to the deduction allowable to a life insurance company in respect of investment expenses. This section is in the following language: "In the case of a life insurance company the term [fol. 39] 'net income' means the gross income less * * * Investment expenses paid during the taxable year: Provided, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of a taxable year."

The gross income of a life insurance company consists only of "the gross amount of income received during the taxable year from interest, dividends, and rents," that is, investment income. Six specific deductions are allowed,

among which is the deduction here involved. Two additional deductions are conditionally allowed under sec. 203 (b). A specific exemption is provided. A life insurance company is not taxable upon its general income from premium receipts or on gain or profit from sale of property.

As shown by the findings, the plaintiff, by a resolution adopted in 1929, undertook to apportion the salaries paid to its general officers and certain general employees as between the underwriting and the investment departments of its business and to include as a direct investment expense an amount ranging from 25 per centum to 80 per centum of such salaries. The amounts so apportioned to and included in the investment expenses, together with all actual and direct investment expenses, were claimed as deductions from gross income for 1929 and subsequent years. The salaries of such officers and cashiers were for services performed and expected to be performed; and such services related to all departments of plaintiff's business, that is, to both the investment and underwriting departments. The percentages of such salaries which the resolution directed be charged to the investment department represented estimates arrived at by such officers, and in the case of the cashiers by estimates arrived at by the supervising officers in charge of such cashiers. The direct investment expenses, that is, the actual expenses about which there is no controversy, which were wholly incurred and paid in the investment department, exceeded an amount computed upon the basis of one-fourth of 1 per centum of the book value of the mean of plaintiff's invested assets.

The case of Sun Life Insurance Company of America v. United States, 81 C. Cls. 892, involved a deduction under [fol. 40] section 203 (a) (5). The question of the proper construction of this section and the extent of the deduction for investment expenses which a life insurance company may take thereunder has been reargued in this case. In the prior case of Sun Life Insurance Company, supra, the history, purpose, and meaning of the section in its relation to the special plan for the taxation of life insurance companies and the relation of the section to the business practices of such companies under the statutes of many states concerning investment expenses were not fully briefed and argued. In view of the facts here disclosed and also in view of important considerations bearing upon the proper interpretation of the section not heretofore considered and dis-

cussed by the court, which are now pressed upon our attention with an earnestness and fullness of argument which they have not heretofore received, we deem the occasion an appropriate one to re-examine the whole subject.

In its returns for each of the years involved, plaintiff deducted from gross income as investment expenses all amounts charged in the investment department representing direct and actual investment expenses wholly incurred and paid in that department, and, in addition, the amounts on account of officers' and cashiers' salaries apportioned to and included in investment expenses in accordance with the resolution. The Commissioner of Internal Revenue determined and allowed the expenses directly and entirely incurred and paid in the investment department, and, in asmuch as these actual investment expenses exceeded one-fourth of 1 per centum of the mean of the book value of plaintiff's invested assets at the beginning and end of each taxable year, he excluded and refused to allow as a part of the deduction that part of the salaries of general officers and cashiers assigned to and included in investment expenses.

Plaintiff contends that this action was contrary to the provisions of section 203 (a) (5), supra. It insists that when a taxpayer makes a determination or when it can submit evidence to show that a certain portion of the time of general officers or employees and a certain percentage of the salaries paid to them for services rendered in all departments of the business reasonably relate to services performed and expenses incurred in the maintenance and op-
[fol. 41] eration of the investment department of the business, such percentage of the total salaries paid may, under the section mentioned, be included in investment expenses and deducted without limitation from investment income for the reason that in such circumstances the portion so assigned to and included in the investment department becomes a direct and actual investment expense.

Plaintiff's position, in substance, is that the term "general expenses" as used in the statute refers specifically and only to those expenses which are not susceptible of division and allocation to the investment and underwriting departments and are incurred for and in behalf of both. We think this position does not take into consideration the fundamental distinction which exists in fact and is observed in the taxing statutes between general expenses and investment expenses. With respect to the former, a part thereof may

be susceptible of reasonable ascertainment and fairly chargeable against investment income and this was recognized and permitted by Congress, as shown by the Committee Reports, to the extent of one-fourth of 1 per centum of the book value of the mean of the invested assets. But, with respect to the latter, no question of division or allocation exists and Congress permitted them to be deducted without limitation. The first part of the section allowing the deduction of investment expenses paid and the proviso excluding all general expenses in excess of a specified amount are to be read and construed together. In view of facts and circumstances which now appear, we think the inclusion of the first without limit and the exclusion of the second in excess of the specified limitation cannot be regarded the same as the inclusion without limit of all of one and a part of the other. And we think also it is of no controlling importance that the officers of the corporation in their judgment make an allocation of general salaries between the Investment and Underwriting Departments. In the circumstances an interpretation which would permit this to be done would require an unauthorized interpolation. The fact that general expenses may be reasonably susceptible of apportionment does not take them out of the class of general expenses within the meaning of the proviso. When so ap- [fol. 42] portioned, either before or after they are incurred, the parts assigned are still impressed with the character of the services or matters in respect of which they are incurred.

We are therefore of opinion that the additional deductions here claimed cannot be sustained under the language and intent of section 203 (a) (5) when that section is considered in the light of the history and reasons for the adoption in 1921 of the special plan for taxing the limited income of life insurance companies. Prior to the enactment of the Revenue Act of 1921, approved November 21, 1921, life insurance companies were by definition included within the term "corporation" and were taxable as ordinary corporations, their gross income, including not only their investment income—that is, their income from interest, dividends and rents—but also their total premium receipts and all other gains and profits from sales of property.[1] This origi-

[1] Corporation Excise Tax Act of 1909, 36 Stat. 11, 112; Revenue Act of 1913, 38 Stat. 114, 172, 173; Revenue Act of 1916, 39 Stat. 756, 765-768; Revenue Act of 1918, 40 Stat. 1057, 1075-1079.

nal plan of taxation, through the inclusion of premium receipts and the allowance of all deductions generally allowed corporations and, in addition, policy claims accrued and paid, etc., was generally unsatisfactory and was productive of almost constant administrative controversy and litigation. As a result the life insurance companies, through the Association of Life Insurance Presidents, proposed to Congress a new plan for the taxation of life insurance companies in connection with the consideration by Congress of the Revenue Bill of 1918.[2] In a written document filed with the Ways and Means Committee at the time the Revenue Bill of 1918 was being considered, the Association of Life Insurance Presidents said, among other things: "Although only a minor proportion of the premiums received by the insurance companies constitutes true income, the greater part being the policyholders' contributions toward current losses and to permanent capital, the entire premium income is included in gross income under the Income Tax Law. This departure from principle is, however, rendered innocu- [fol. 43] ous through deductions expressly allowed by the statute." The plan submitted by the insurance companies proposed to place life insurance companies in a special class for the purpose of Federal taxation, and to change the basis of tax theretofore existing so as to include in gross income only the investment income of the companies consisting solely of interest, dividends, and rents, the deductions proposed in connection with this plan being expressly limited to those directly relating to the production of investment income.[3] The House did not adopt the proposed plan in the Revenue Bill of 1918. However, the Senate Finance Committee recommended in the 1918 Revenue Bill the plan proposed, which plan was later adopted and included as law in the Revenue Act of 1921. The amendment proposed by the insurance companies which was adopted and recommended to the Senate by the Finance Committee in the Revenue Bill of 1918, insofar as it related to the deduction from gross income for investment expenses, was as follows:

"Section 246. (a) That in the case of an insurance company taxable under section 245 the term 'net income' means the gross income less * * * (4) Investment expenses

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[2] Hearings before the Committee on Ways and Means, H. R. 12863, 65th Cong., 2d Sess., on the proposed Revenue Act of 1918, Pt. 1, p. 811.

[3] Senate Rep. 617, 65th Cong., 3rd Sess., p. 9.

during the taxable year not exceeding one-fourth of 1 per centum of the mean of the invested assets." In presenting the bill, Senator Simmons, chairman of the Finance Committee, stated that it had been framed after consultation with many representatives of the life insurance companies.[4]

The plan proposed for the taxation of life insurance companies was approved and adopted by the Senate, but was thereafter abandoned in conference.

The above limitation of one-fourth of 1 per centum, which had been proposed by the life insurance companies themselves, on the deduction "for investment expenses" was exactly the limitation which had long been in force and effect in the State of New York, as well as in various other states, under which life insurance companies in making their Annual Statements to the Insurance Departments of the various states had been limited by law to an arbitrary deduction for investment expenses not exceeding one-fourth [fol. 44] of 1 per centum of the mean of their invested assets. Section 33 of the Laws of New York (1906), ch. 326, which added section 97, provides as follows:

Limitation of Expenses, * * *. No such corporation (domestic life insurance corporation) shall make or incur any expense or permit any expense to be made or incurred upon its behalf or under any agreement with it, except actual investment expenses (not exceeding one-fourth of 1 per centum of the mean invested assets) * * *.

It will thus be seen that the provision with reference to the deduction for investment expenses in the Revenue Bill of 1918 suggested by the life insurance companies and adopted by the Senate was not new, and that the limitation on expenses which the companies could take against investment income in all circumstances was one-fourth of 1 per centum of the mean of invested assets. There was no provision for the allowance of actual investment expenses beyond that limitation. The percentage specified was then deemed to be adequate by the insurance companies themselves, the State Insurance Departments, and the Senate.

The question of how life insurance companies should be treated for the purpose of Federal taxation again came before Congress in the consideration of the Revenue Bill of 1921. The life insurance companies through the Associa-

[4] Cong. Rec., Vol. 57, Pt. I, p. 254.

tion of Life Insurance Presidents [5] renewed efforts to obtain a separate classification for purposes of Federal taxation. The Revenue Bill of 1921 as introduced in the House contained the plan for taxing life insurance companies which had theretofore been adopted by the Senate in 1918. (H. Rep. No. 350, 67th Cong., 1st Sess., p. 14.) When the 1921 Revenue Bill was before the Senate Finance Committee a representative of the life insurance companies stated that "all the life insurance companies are behind that [fol. 45] scheme and are satisfied with it." [6] Thereafter, in due course, the Congress after much consideration and consultation with the representatives of the life insurance companies, and with the approval of at least most of the life insurance companies, finally enacted the Revenue Act of 1921, section 245 (a) (5) of which was the same as the provisions of section 203 (a) (5) now under consideration.[7]

At this point it should be noted that the provision with respect to the deduction allowed for investment expenses as finally adopted in the 1921 Act is more liberal as to the amount which may be deducted for investment expenses under certain circumstances than was the original provision proposed in connection with the Revenue Bill of 1918, in that life insurance companies are allowed all actual investment expenses, whereas, under state law and the provision proposed by the life insurance companies and adopted by the Senate in connection with the 1918 Revenue Bill, no investment expenses in any circumstances were allowable beyond the limitation of one-fourth of 1 per centum of the mean of

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[5] At the Annual Meeting of Life Insurance Presidents, December 1920, it was stated in a paper read by Mr. E. E. Rhodes, Vice President of the Mutual Benefit Life Insurance Company, on "Federal Taxation of Life Insurance" that the basis of the income tax was unsatisfactory both to the companies and to the Government, and that a plan similar to that embodied in the Senate Amendment to the 1918 bill should be adopted. Proceedings of the Fourteenth Annual Meeting, pp. 141, 143-145.

[6] Hearings before the Senate Finance Committee, 67th Cong., 1st Sess., on H. R. 8245, September 1-October 1, 1921, p. 84. See also S. Rep. No. 275, 67th Cong., 1st Sess., p. 20.

[7] See sections 242-245, 1921 Act, for the original plan specially taxing life insurance companies, which plan, so far as material here, has remained the same in all subsequent revenue statutes.

the invested assets. But this liberalization was not without limitation and such liberalization applied only in cases where the company did not include any general expenses in its actual investment expenses. In order to control the deduction to be taken against the limited income which was being taxed, and thus avoid uncertainty in respect of the net income of life insurance companies that it chose to tax, Congress limited the deduction to one-fourth of 1 per centum of the book value of the mean of the invested assets "if any general expenses are assigned to or included in investment expenses." The evident purpose and reason for this more liberal provision with reference to the deduction of actual investment expenses, regardless of amount (but subject to the original limitation of one-fourth of 1 per centum if any expenses of a general character were assigned or included), was due to the fact that some of the newer or smaller life [fol. 46] insurance companies (principally the mid-western companies, as shown in the case at bar), where the nature of the companies' investments required field work, invested their funds largely in farm loan mortgages which produced higher rates of interest income and involved also proportionately higher expenses in connection therewith, such as expenses for salaried field representatives for procuring and servicing such loans. The investments of the older and eastern companies were more largely in stocks and bonds which produced a lower interest income and, correspondingly, lower expenses in connection therewith because of such investments being made in a more direct manner. In these circumstances it was known that the actual investment expenses, that is, the expenses directly and entirely incurred in the investment department alone, of the smaller companies might exceed one-fourth of 1 per centum of the book value of the mean of their invested assets, but that in the case of the larger companies, which always hold very large amounts of invested assets, the limitation originally proposed by the life insurance companies would always be sufficiently adequate to cover their actual investment expenses.[8]

[8] The Treasury Department in regulations and practice has uniformly permitted deductions without limitation of direct and actual investment expenses and has uniformly held life insurance companies to the limitation of one-fourth of 1 per centum, when, by whatever method or plan employed, any company assigned to or included in its investment expenses any expense of a general nature, such as general officers' salaries, etc.

Experience has shown that this comparison is correct for the reason that the question with reference to the right to apportion a part of the general expenses to investment expenses, in order to obtain a deduction in excess of one-fourth of 1 per centum of the mean of the invested assets, has only arisen in court in two cases, other than the present case, during the seventeen years the provision has been in effect.

In the instant case, plaintiff's direct and actual investment expenses for 1929, which were allowed by the Commissioner of Internal Revenue and about which there is no dispute, amounted to approximately $37,000, whereas one-fourth of 1 per centum of the mean of the book value of plaintiff's [fol. 47] invested assets at the beginning and end of that taxable year was only approximately $21,000. For 1930 the Commissioner allowed a deduction of actual investment expenses of $42,000 as against such a limitation of $23,000; for 1931 he allowed a deduction of $41,000 as against a limitation of $24,000, and for 1932 a deduction of $37,000 as against a limitation of $24,000. Plaintiff seeks to augment the deductions allowed by the Commissioner for actual investment expenses wholly incurred in that department by an amount in excess of $17,000 for 1929 on account of the allocation to and inclusion in such investment expenses of a portion of the general officers' and employees' salaries, and of more than $21,000 for 1930; $24,000 for 1931, and $26,000 for 1932. These figures appear to illustrate the reason why Congress deemed it advisable to limit the deduction on account of investment expenses to one-fourth of 1 per centum of the mean of the invested assets when the actual investment expenses wholly incurred and paid in maintaining and operating the investment department did not equal or exceed the limitation. Another reason for denying a deduction of any part of a general expense in excess of the limitation was that general income, such as underwriting income and gains and profits on the sale of assets, was being excluded and exempted from taxation. Inasmuch as only the income from the investment department was being made subject to the tax, it would seem that Congress intended that only the actual investment expenses should be allowed when a deduction in excess of one-fourth of 1 per centum was to be permitted. If this were not true the proviso would seem to have no purpose and its provisions would be rendered of no value. It is well established that Congress may condition, limit, or deny deductions from gross income in order to arrive at the

net income that it chooses to tax. Burnet v. Thompson Oil & Gas Co., 283 U. S. 301; Helvering v. Independent Life Insurance Co., 292 U. S. 371.

The reason for exempting premium income of a life insurance company from taxation was because the greater portion, that is, the net premiums paid and also the reserve built up and maintained therefrom with interest, really belongs to the policyholders. In the total of each annual premium paid, there is always included an amount which, [fol. 48] upon the basis of experience, will be sufficient to pay the expenses of the company. Finding 22. New York Life Insurance Co. v. Edwards, 8 Fed. (2d) 851, 853. In that case the court said:

> • • • But the net or mathematical premium is not the full amount each member must pay into a going concern, because it contains no provision for expense of management and unforeseen contingencies, such as excess mortality, diminished interest, investment losses, increased taxation, and the like. Therefore, to provide for these, there is added to the net or mathematical premium a sum technically called "loading." The net or mathematical premium plus the loading constitutes the company's table rate of premium or level premium, and is the estimated sum named in the policy as premium to be paid in advance and adjusted to cost when cost is known, and is the maximum sum which the company can ever require the insured to pay.

Inasmuch, therefore, as premium income was not being taxed and the untaxed premiums contained amounts for payment of the company's expenses, including all its general expenses, the Congress deemed it necessary to make specific provision as to the maximum deduction allowable against the taxable investment income so as to prevent the apportionment and the inclusion of the general expenses in this deduction. When investment expenses wholly incurred in that department do not equal or exceed the limitation specified, the amount of the deduction is entirely arbitrary; however, as stated in the reports of the Congressional Committees,[9] it was considered that adequate provision had been

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[9] H. Rep. No. 350, 67th Cong., 1st Sess., p. 14; Senate Rep. No. 275, 67th Cong., 1st Sess., p. 20.

made for "suitable deductions for expenses fairly chargeable against such investment income."

It is well known, and is admitted in this case, that the expenses of a life insurance company generally fall into three classes, to-wit, underwriting expenses, which are those expenses directly relating to and wholly incurred in that department; investment expenses, which are expenses directly relating to and entirely incurred in the maintenance and operation of the investment department; and general ex- [fol. 49] penses, which include, and can only include, all expenses which are not definitely and entirely either investment or underwriting expenses. The last-mentioned class constitutes the only class of expenses to which the proviso of section 203 (a) (5) could relate. The additional deductions on account of salaries of general officers and employees claimed in this case are a part of this class of expenses as they relate both to the investment and the underwriting departments. The taxpayer in this and other cases sought to include a portion thereof in the deduction for actual expenses in excess of the limitation of one-fourth of 1 per centum by submitting evidence to show that the services and matters for which the expenses were paid had some relation to the investment department and that an apportionment and allocation of a part of such expenses could be made to the investment department on the basis of a reasonable value for such services or other matters to the investment department. Such apportionments and allocations involve approximations, estimates, or guesses which were a feature of administration which, it appears, Congress desired by the proviso to avoid.

In connection with plaintiff's contention that the term "investment expenses" means, and was intended to mean, any expense of a general nature which might be susceptible of reasonable apportionment and allocation as between the underwriting department and the investment department of the business, reference may be made to the discussion of this provision when it was before the Senate Finance Committee.[10] At that time Dr. Adams, who was the representative of the Treasury Department, in discussing the section here under consideration with the committee, pointed out that the

[10] Hearings before the Senate Committee on Finance, 67th Congress, 1st Sess., on the Revenue Bill of 1921. H. Rep. 8245, pp. 89-90.

purpose of this section relating to deductions for investment expenses with the limitation mentioned was to permit those life insurance companies which "very vigorously and exactly allocate or set aside their investment expenses" to deduct such investment expenses and that companies which did not keep their investment expenses accurately and exactly segre- [fol. 50] gated from all other expenses would not be permitted to take a deduction in excess of one-fourth of 1 per centum of the book value of the mean of the invested assets. He was questioned by the chairman of the committee concerning the limitation of one-fourth of 1 per centum, to which he replied that such limitation was a check then imposed upon life insurance companies by law; that "they are quite habituated to it and the practice has shown that it apparently is also quite accurate. If they can allocate and say absolutely just what their investment expenses have been, they are permitted to take them. If they do not go to that trouble, they are not permitted to take more than one-fourth of 1 per centum of the book value of the mean of the invested assets." This explanation when considered in the light of the language of the section shows that the Treasury Department was placing upon the section a construction which would permit a taxpayer to deduct more than one-fourth of 1 per centum of the book value of the mean of the invested assets only when the taxpayer accurately allocated and could say absolutely just what its actual investment expenses had been, and that if such taxpayer did not accurately segregate or allocate its actual investment expenses, that is, those expenses relating directly and entirely to the investment department, it could not have a deduction greater than one-fourth of 1 per centum. In view of the facts and circumstances disclosed by this record, we think this is the correct interpretation of the section. To allocate and say absolutely just what their investment expenses have been precludes the idea (in view of the language of the proviso) of a division of general expenses and the assignment or inclusion of a portion thereof as an "investment expense." If expenses, such as salaries of general officers and employees, which are not entirely incurred and paid in the maintenance and operation of the investment department, may be divided and assigned or allocated in part to the investment department, there would no longer be any "general expense" to which the proviso could apply for substantially all expenses of the company would by that method of division and assignment

become either a direct investment expense or a direct underwriting expense, and the sums assigned to and included in [fol. 51] the investment department deductible without any limitation whatever.[11] The proviso would then be rendered of little, if any effect.

The proviso of the section under consideration seems further to have contemplated that in some cases the actual investment expenses would not equal one-fourth of 1 per centum of the mean of invested assets and that certain general expenses of the insurance company might, with some degree of reasonableness, be said to have some direct relationship to the investment department and also to be reasonably susceptible of division and assignment in part to the different departments of the business. The proviso was therefore so worded as to make it plain that while this was not being prohibited from a bookkeeping or business standpoint the deduction allowable would be limited to the amount specified if it should be found that the actual investment expenses, exclusive of the portions of any general expenses included, were less than an amount computed on the basis of one-fourth of 1 per centum of the book value of the mean of the invested assets. In other words, the term "investment expenses" when considered in connection with the term "general expenses" in the proviso can only mean expenses directly and entirely relating to the investment department, for the language of the proviso permits a taxpayer to include in its investment expenses general expenses

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[11] Among other expenses of a general nature which could with equal facility be apportioned and assigned in part to the investment department, the following might be mentioned: (1) General advertising; (2) salaries of legislative counsel, public relations counsel, and advertising manager; (3) costs of publishing and mailing annual reports and financial statements; (4) sums paid to inactive general employees or pensioners and contributions to pension funds; (5) traveling expenses of company officials attending agency and national conventions; (6) dues and assessments paid to certain bureaus and associations; (7) costs of books, newspapers, and periodicals not used exclusively in either the investment or underwriting departments; (8) public liability insurance premiums; (9) charitable donations and contributions; and (10) license fees paid to various states for the privilege of doing business therein.

in whole or in part to an amount which when combined with the actual investment expenses does not exceed one-fourth of 1 per centum of the mean of invested assets. Therefore, under the strict letter of the statute, and no reason appearing to require the conclusion that the intention of Congress [fol. 52] differed from the ordinary meaning of the language used, the plaintiff having assigned a portion of its general expenses to its investment expenses, and since its actual investment expenses allowed by the Commissioner exceeded one-fourth of 1 per centum of the book value of the mean of plaintiff's invested assets, no additional amount in respect of the allocation made by plaintiff can be allowed.

If the plaintiff in this case should be permitted to make a division of the salaries of the general officers and employees and to assign to and include in investment expenses the amounts which it seeks to include in this case, we would be forced under our interpretation to restrict the total allowance in each year for investment expenses to an amount which would be only slightly more than one-half of the amount which the Commissioner actually allowed for each year. The Commissioner's allowance in each year, although it exceeded one-fourth of 1 per centum of the mean of plaintiff's assets, was correct for the reason that he was able to allocate and say absolutely just what plaintiff's actual investment expenses had been. We are now of opinion that this construction of the provision under consideration conforms in every respect and in each class of cases to both the letter and the spirit of the statute and to the known facts out of which grew the special plan, of which the deduction for investment expenses is an important part, for the taxation of life insurance companies.

The cases of Sun Life Insurance Company of America v. United States, supra, and Volunteer State Life Insurance Company v. Commissioner of Internal Revenue, 27 B. T. A. 1149, cited and followed in the Sun Life case, did not consider and discuss the deduction under section 203 (a) (5) in the light of certain facts and circumstances which here appear and which we now think are controlling upon the question involved.

Plaintiff is therefore not entitled to an additional deduction on account of the salaries of officers and employees which the facts show were for services relating "to matters in all departments of plaintiff's business, that is, in both the investment and underwriting departments."

The second question is whether, in determining net income, a life insurance company is entitled to a deduction on account of reserves held for health and accident (casu- [fol. 53] alty) insurance; that is, are casualty reserves to be treated and deducted as "reserves required by law" within the meaning of the provisions of the taxing act relating solely to life insurance companies. Reserves for accidental death benefits have been allowed and are not in controversy here—finding 20.

The provisions of the Revenue Act of 1928 pertinent to this question are as follows:

Sec. 201. Tax on life insurance companies.

(a) Definition.—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

Sec. 202. Gross income of life insurance companies.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

Sec. 203. Net income of life insurance companies.

(a) General rule.—In the case of a life insurance company the term "net income" means the gross income less * * *.

(2) Reserve funds.—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection [tax free interest] of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation), 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only; * * *.

The corresponding provisions of the Revenue Act of 1932 are identical with the foregoing, except that subdivision (2) of section 203 (a) provides for the use of a rate of 3¾ per centum of the mean of the reserve funds instead of 4 per centum in any case where the reserve funds are computed at an interest assumption rate lower than 4 per centum.

[fol. 54] The facts show that in computing the deduction for each year at the percentage specified, plaintiff included the reserves held under health and accident insurance written by it. For 1929 and 1930 the Commissioner of Internal Revenue permitted plaintiff to include in its reserve fund, on which the deduction under section 203 (a) (2) of the Revenue Act of 1928 was computed, the reserves held by plaintiff for health and accident (casualty) insurance in the case of both "Active Lives" and "Disabled Lives," but for 1931 and 1932 he allowed such casualty reserves to be included only for "Active Lives" and excluded the reserves for "Disabled Lives." Plaintiff seeks to recover alleged overpayments for 1931 and 1932 on the ground that the health and accident reserves held by it in the case of "Disabled Lives" were properly to be included in determining the total of the "reserve funds required by law" within the meaning of the above-quoted sections, 201 (a) and 203 (a) (2).

The defendant, while not seeking an affirmative judgment, since the assessment of any additional tax for any of the four years involved is barred, contends here that the allowance of any reserve deduction on account of health and accident insurance, whether for "Active Lives" or "Disabled Lives," is erroneous. In other words, the defendant contends that under sections 201 (a) and 203 (a) (2), Acts of 1928 and 1932, the reserve to be used in determining the deduction to be allowed to a Life Insurance Company means the amount which is attributable to and represents the value of the life-insurance elements of the policy contracts and does not include casualty reserves. It is the position of defendant that only those reserves held under contracts involving life contingencies are deductible by a corporation taxable as a life insurance company.

It is agreed that plaintiff is in fact and in law a life insurance company and that it is taxable only under those provisions of the statutes which relate exclusively to life insurance companies. As stated under the first issue, the pro-

visions which impose the tax only upon investment income of such companies have been the same under all the revenue acts since, and including, the Revenue Act of 1921, and [fol. 55] under these statutes a life insurance company is not taxable on underwriting income or on earned premiums, or gains or profits which it may realize on the sale or disposition of any of the numerous assets which it necessarily owns. For this reason the taxing acts do not permit deductions to life insurance companies upon the same basis as deductions are allowed to other classes of insurance companies or to corporations in general. The section under which the deductions on account of health and accident reserves here involved are claimed by plaintiff to be allowable provides for a deduction of an amount equal to 4 per centum of the mean of the reserve funds required by law to be held at the beginning and end of the taxable year. This provision relates exclusively to life insurance companies, either stock or mutual, and does not relate and is not to be found in the provisions of the statutes relating to the taxation of casualty insurance companies or to other classes of insurance. The provisions of section 203 (a) (2) are entirely unlike the provisions of section 208 (c) (1) (A) of the Revenue Acts of 1928 and 1932 permitting "Mutual Insurance Companies other than Life" to deduct the net addition required by law to reserve funds. Such companies are taxable upon premium received and all other income, and the deduction of the net addition to reserve funds is allowed in addition to the deductions specified in section 23.

The question here, therefore, is whether the term "reserve funds required by law" (sec. 203 (a) (2)), which relates to reserves of life insurance companies only, includes when considered with section 201 (a), reserves held by a life insurance company on account of outstanding policies of health and accident insurance, that is, casualty insurance, as well as reserves held on account of outstanding life insurance policies. We are of opinion that reserves held under health and accident insurance contracts are not properly to be included in the reserve fund required by law to be held by a life insurance company for the purpose of deduction from income for tax purposes.

The definition of a life insurance company as set forth in section 201 (a) quoted above was enacted for the purpose of taxing insurance companies according to the predominant kind of insurance issued by them. It was not necessary to

[fol. 56] define other insurance companies for the reason that the revenue acts treat them separately and classify them either as "Insurance Companies other than Life or Mutual," which includes a casualty insurance company (sec. 204, Act of 1928), or as "Mutual Insurance Companies other than Life" (sec. 208). The gross income of insurance companies taxable under sections 204 and 208 includes the combined gross amount derived during the taxable year from investment income, from underwriting income, and from gain from the sale or other disposition of property, less the deductions therein specified.

Basically the question whether the health and accident (casualty) reserves claimed by plaintiff are a part of its "reserve funds required by law" within the meaning of section 203 (a) (2) depends upon the question whether such health and accident reserves are to be included in the reserves for life insurance and annuity contracts for the purpose of determining whether an insurance company is a "life insurance company" within the meaning of section 201 (a) of the Revenue Act of 1928 for the purpose of taxation under sections 202 and 203. Both parties agree as to this. The first consideration, therefore, is directed to the comparative to be used in determining whether an insurance company is a "life insurance company." We are of opinion that since the purpose of the definition contained in section 201 (a) is one of classification, the test provided is the amount of reserve funds held for life insurance and annuity contracts as against the reserve funds of the company concerned which are held for health and accident insurance, and that the words "total reserve funds" used in that section mean the sum of the life insurance and annuity contract reserves and the health and accident, or casualty, reserves. This section was dealing only with technical insurance reserves, rather than with the total of such reserves plus reserves for pure liabilities. The purpose of the section was to provide a simple rule to be applied in determining whether an insurance company which writes life insurance and annuity contracts, and, also, health and accident insurance, should be taxed under the special plan specified in sections 202 and 203 relating exclusively to life insurance companies, or whether such [fol. 57] companies should be taxable under section 204.

Insurance companies issuing life insurance and annuity contracts may, and many do, write health and accident in-

surance. This is casualty insurance, and is the only kind of insurance other than life that a life insurance company writes or is permitted to write under the laws of the various states. The statutes of the State of Washington, the home state of plaintiff, classify health and accident insurance as casualty insurance, and also specifically provide that this is the only kind of insurance other than life that a life insurance company is permitted to issue.[13] For these reasons we think it is clear that the comparative in the definition stated by Congress under which an insurance company is to be classified either as life or as a casualty company is that existing between the reserves of such company for life insurance and annuity contracts and its health and accident reserves. When section 242 of the Revenue Act of 1921, which was the same as section 201 (a) here involved, was under consideration by the Finance Committee of the Senate[14] a representative of the Treasury Department was asked by the committee to "Explain that 50 per cent of its total reserve funds, and why take 50 per cent instead of some other figure?" to which Dr. T. S. Adams, representing the Treasury Department, replied "Some companies mix with their life business, accident and health insurance. It is not practicable for all companies to disassociate those businesses so that we have assumed [in drafting the bill which was then being considered by the committee] that if this accident and health business was more than 50 per cent of their business, as measured by their reserves, it could not be treated as a life insurance company. On the other hand, if their accident and health insurance were incidental and represented less than 50 per cent of their business we treated them as a life insurance company."

If the phrase "total reserve funds" at the end of section 201 (a) means the total of all the reserves for all classes of [fol. 58] insurance written by the insurance company under consideration, the definition, would under plaintiff's contention, be rendered meaningless and every insurance company writing life insurance would be a life insurance company even though its casualty reserves constituted the largest

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[13] Pierce's Code (1929), Vol. 1, Washington General Statutes. Sections 2990 (83), 2991 (84), 2999 (92), and 3001 (94).

[14] Hearings before the Committee on Finance of the Senate, 67th Cong., 1st Sess. (H. R. 8245), pp. 92-93.

proportion of all its insurance business. If the term "total reserve funds" refers to and includes the company's total liabilities, for which all state laws require insurance companies to hold reserves, the definition would be rendered useless.

The net value reserves of a life insurance company, whether or not it also writes health or accident insurance, always constitute the greater portion of its total liability reserves. This is true of any insurance company, whether life or casualty. This is disclosed by the published reports of "The New York State Insurance Department," which show that in all life insurance companies reporting in that state the net value reserves of such companies constitute approximately from 85 to 90 per centum of their total liabilities. These averages are also true in respect of plaintiff's net value reserves. While it does not report to the New York Insurance Department, since it does no business in that state, its annual statements are published in "Best's Life Insurance Reports," which show that plaintiff's net value reserves for all classes of insurance issued by it have always averaged about 90 per centum or more of its total net liabilities, that is, about the same as all other insurance companies doing the same class of insurance business. In these circumstances there would be no necessity for a classification upon the basis provided in that section since the reserves of an insurance company writing life insurance and annuity contracts, whether or not it also writes health or accident insurance, held on account of the net values of insurance contracts would never be less than 50 per centum of its total liabilities. The nature of the insurance business precludes that possibility.

Inasmuch as the comparative for determining whether an insurance company is taxable as a life insurance company under section 202, or as a casualty company under section 204, is the ratio between its life reserves and its casualty reserves, and, by this test, it being undisputed that [fol. 59] plaintiff is a life insurance company, its tax is to be exclusively determined under the provisions relating to life insurance companies.

This brings us to the next phase of the question, which is whether casualty reserves, that is, the reserves for health and accident insurance issued by plaintiff, come within the provisions of section 203 (a) (2) which, as hereinbefore stated, allow a deduction to a life insurance company of an

amount equal to 4 per centum of the mean of the reserve funds required by law to be held at the beginning and end of the taxable year.

Since the statute places life insurance companies in a special class and taxes them upon only a portion of the gross income as defined in cases of other classes of corporations and insurance companies, we are of opinion that Congress used the term "reserve funds" in section 203 (a) (2) in the same sense in which it was used in section 201 (a) just considered. In other words, when an insurance company has been classified as a life insurance company in accordance with section 201 (a), the reserves to be included under section 203 in determining the 4 per centum deduction are those reserves which are held by such company on account of its life insurance and annuity contracts. This excludes reserves for such casualty insurance as a life insurance company may write. Additional reasons which we think require the conclusion that casualty reserves are excluded in determining the reserve deduction allowable to a life insurance company are (1) that Congress placed such a company in a special class and taxed it upon only its investment income and that this classification and method of taxation were due to the fact that reserves for life insurance and annuity contracts really belong to the policyholders, and (2) that premiums paid on casualty insurance belong to the insurance company and the reserves required to be maintained therefor by state laws are, in effect, and from the standpoint of Federal taxation, liability or solvency reserves because if the casualty, to which the health and accident contract relates, does not happen or if the policy should lapse or be canceled the company is never called upon to make any payment. This, we think, was the reason for taxing casualty companies in the manner specified in sec- [fol. 60] tion 204. An insurance company incorporated as a casualty company does not write life insurance, although some life insurance companies write casualty insurance.

The meaning of the phrase "reserve funds required by law" as used in the taxing acts in its relation to a life insurance company has been decided in a number of cases. Helvering v. Illinois Life Insurance Company, 299 U. S. 88, 90, 91, involved deductions claimed for reserves held on account of the survivorship investment fund feature of certain life insurance policies, and the question was whether reserves for this feature of the policies were to be included

in determining the allowable deduction. The court said at pages 90, 91:

*The phrase "required by law" includes only reserves that directly pertain to life insurance.* Other reserves, even though required by state statutes regulatory of the business authorized to be carried on by life insurance companies, are not included. * * *

Its [the life insurance company's] life insurance liability arises upon the death of the insured. Ascertainment of the reserves attributable to that liability involves consideration of the amount contributed to them out of premiums plus interest for a period estimated on the basis of mortality. The survivorship investment fund feature of these policies has no relation to life insurance risks. [Italics supplied.]

The case of Continental Assurance Co., Inc. v. United States, 79 C. Cls. 756, 765, involved deductions for reserves held for coupons attached to certain life insurance policies of a stock company, which were equivalent to dividends in the case of a Mutual Life Insurance Company, and the question was what reserves of a life insurance company are included in the term "reserve funds required by law." We held that the reserve contemplated in the taxing act is that fund which when added to the present value of future net premiums is equal to the present value of future death claims; that is, the mathematical equivalent of the obligation incurred by the company to pay the sum insured at the death of the policyholder, or upon the surrender and cancel-ation of the policy. The principle decided in that case was approved in Helvering v. Inter-Mountain Life Insurance Company, 294 U. S. 686, 690, in which the court held that "In life insurance the reserve means the amount, accumulated [fol. 61] by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts."

The facts in the case at bar show that plaintiff's reserves for health and accident insurance are not held on account of life insurance and that they are not of the same character as technical life insurance reserves. They do not include life contingencies. Such casualty reserves are calculated upon the basis of Tables of Probabilities as reserves for other classes of casualty risks are computed. These reserves are required by the law of Washington to be computed upon the net premium basis and they do not involve

the element of life insurance as a liability. The life risk is the basis of life insurance reserves. Although the experience tables used in computing health and accident reserves take into consideration the mortality element, this is merely incidental and does not involve the element of life risk as in the case of life insurance. The purpose of considering the mortality element and the nature of the risk in casualty insurance is the opposite of that of the reserve for the life risk in a life insurance policy. The mortality element in a life policy requires the establishment of a reserve sufficient to meet the policy obligations at maturity; that is, at death. In the case of health and accident insurance death, instead of maturing the liability, terminates the risk with respect to the payment of liability for disability benefits. The health and accident reserve is never built up or maintained to provide for a life risk, inasmuch as there is no such risk which the company can ever be called upon to meet in health and accident insurance.

Plaintiff insists that the health and accident reserves here involved are deductible for the reasons that they are set up and maintained out of premiums, are calculated upon an experience table applicable to the nature of the risk, and are held to meet contingent policy obligations at maturity. But under the scheme for taxing life insurance companies this is not controlling and does not render them of the same character as life reserves. All casualty reserves have these characteristics. But life insurance reserves, as hereinbefore mentioned, are, in effect, and always in the end, the property of the policyholder. This was the reason for the [fol. 62] adoption of the special method of taxing life insurance companies. The holder of a life insurance policy may demand and receive the reserve which is shown in the table of loan and non-forfeiture value of the policy, and if the policy lapses before death a life insurance company must account to the insured for the full reserve value of the policy. This is not true of any other form of insurance and more particularly of casualty insurance involved in the case at bar. The net value of the health and accident policy is not increased by the reserves. They are never returnable in any amount to the policyholder if the policy lapses, is surrendered, or otherwise terminates. Moreover, the contingency for which such reserves are maintained may never happen. In that event the interest included in the reserve, and non-taxed, is released to the absolute use and benefit

of the company. There is no provision in the statute relating to life insurance companies for the taxation of this interest element of the casualty reserves, when so released. This, we think, is the very basis of the definition, for if a life insurance company is to be taxed only upon its income from investments and not on its premium income, or from gains or profits generally, the Congress did not intend to allow such company a deduction in respect of premium income that belonged to it even though in respect of such premium income it might later be called upon to make some payment.

Why was a company which writes life and also casualty insurance made taxable as a life insurance company or a casualty company according to the amount of reserves maintained for each class of insurance? We think the answer is, that if the greater proportion of its business is life insurance it would be unfair to tax it upon its premium receipts and gains or profits, because the net premiums belong to the policyholders, whereas, if the larger proportion of the business is casualty insurance, the company should be taxed under section 204 on its premium receipts and other income, because such premiums belong to the company, and the reserves for any payments which the company might be called upon to make would have no place for tax purposes in the plan of taxation since they are, from that point [fol. 63] of view, in the nature of liability or solvency reserves. It is well settled that liability or solvency reserves are not deductible by the company taxable as a life insurance company. As above stated, if a company is taxed as a life insurance company and is permitted to deduct casualty reserves which it may never be called upon to use for the purpose of making any payments under its contracts, such company would be obtaining an undue advantage for the reason that a portion of the only income taxable under the provisions relating solely to life-insurance companies would entirely escape taxation to the extent that the health and accident policies otherwise might lapse, be canceled, or terminate by death. We think that Congress intended the reserve deductions to conform to the special plan for taxation of life insurance companies. The inclusion of reserves maintained out of premiums which belonged, when paid, to the company would not comport with the statutory plan.

Plaintiff contends, however, that if casualty reserves are to be excluded in any cases it was not the intention of the act to exclude them in combined policies of Life, Health, and Accident Insurance. We think this is unimportant. The health and accident portion of the combined policies are entirely separate contracts, New York Life Insurance Company v. United States, 12 Fed. (2d) 643. The health and accident premiums are separately shown therein. The specimen policy in evidence in this case shows that with the page covering casualty insurance removed it is a complete life insurance policy. When the insured desires health and accident insurance it is only necessary for the company to insert a page covering that class of insurance in its regular insurance policy form. Moreover, the disability insurance may be discontinued without affecting the life insurance and the reserves held on account of the health and accident insurance do not enter into the amount of the reserves held by the company on account of life insurance covered by the policy, or the surrender, cash, or loan value shown therein. The two contracts are as separate and distinct as if written in separate policies. Plaintiff combines the two classes of insurance in one policy for the reason that it does [fol. 64] not write disability insurance except when the applicant also purchases life insurance.

Plaintiff further contends that it is entitled to a deduction in respect of the health and accident reserves for the reason that they are technical insurance reserves. We think this contention cannot be sustained for the reasons above stated and for the further reason that we are here concerned with a life insurance company and the casualty reserves in question are not technical life insurance reserves. Their allowance would therefore result in a deduction to a life insurance company for casualty reserves which even a casualty company is not permitted to take for this class of insurance under the taxing provisions relating to such companies. The decisions of the United States Board of Tax Appeals in The Equitable Life Assurance Society of the United States v. Commissioner of Internal Revenue, 33 B. T. A. 708; Monarch Life Insurance Company v. Commissioner, 38 B. T. A. 716; Pan-American Life Insurance Company v. Commissioner, 38 B. T. A. 1430; and Oregon Mutual Life Insurance Company v. Commissioner, (memorandum opinion), docket nos. 85182 and 88299, do not appear to have given consideration and weight to this dis-

tinction. These decisions of the Board of Tax Appeals appear to rest upon the proposition that any reserve which is a technical insurance reserve is deductible by a life insurance company taxable under those provisions relating exclusively to such companies. The distinction between technical life insurance reserves and other technical insurance reserves, including liability of solvency reserves, has been observed in the leading cases, especially the more recent decisions upon the subject of technical insurance reserves, both in respect to the question of the net additions to reserve funds arising under the earlier revenue acts and to the deduction of 4 per centum of the mean of the reserve funds under the provisions relating entirely to life insurance companies in the Revenue Act of 1921 and subsequent acts. A comparison of the decisions in McCoach v. Insurance Company of North America, 244 U. S. 585; United States v. Boston Insurance Co., 269 U. S. 197; New York Life Insurance Co. v. Edwards, 271 U. S. 109, and other [fol. 65] cases similar in character, with the decisions in Helvering v. Inter-Mountain Life Insurance Co., supra; Continental Assurance Co., Inc. v. United States, supra; and Helvering v. Illinois Life Insurance Co., supra, discloses an adherence to the principle that "reserve funds required by law" within the meaning of the taxing acts are those technical insurance reserves which are peculiar to the character of insurance companies claiming the deduction. In other words, a company which is taxable as a life insurance company may deduct only technical life insurance reserves which is the reserve attributable to and represents the value of the life insurance elements of the policy contracts.

Plaintiff also contends that inasmuch as interest is credited to the health and accident reserves here involved a proper consideration of its contractual obligations would require that such interest be exempted from taxation under the statute which lays a tax only upon investment income. This is a matter of policy which rests with Congress. It was evidently considered that the amount of casualty premiums which the company would probably never be called upon to pay under its health and accident insurance would sufficiently compensate for the taxation of any interest element in such reserves. Moreover, the interest element was involved in other reserves which have been denied as deductions to a life insurance company in certain of the cases

hereinbefore cited. In addition, it should again be pointed out in this connection that this form of casualty insurance is taxable, if at all, under the provisions of the statute relating to insurance companies other than life or mutual. The basis upon which such insurance is taxable is quite different from that of life insurance companies and no deduction whatever is allowed on account of the mean of the reserve funds, but instead a deduction is allowed for claims accrued or losses incurred. In the classification of a company for the purpose of Federal taxation, advantages as well as disadvantages to the taxpayer may occur. By being classified as a life insurance company plaintiff avoids the tax on premium income from its health and accident insurance for the reason that the provisions relating to a life [fol. 66] insurance company do not lay a tax upon earned premiums nor upon gains or profits on the sale or other disposition of property. Neither does the statute, insofar as it relates to life insurance companies, permit deductions on account of that class of business. As was said by the court in Shapleigh Hardware Co. v. United States, 81 Fed. (2), 697, "The question is not whether this is a deduction which the taxpayer should, in fairness, be permitted to take, but whether it is a deduction which is clearly provided for in the Revenue Act." The presence of interest in a reserve does not, of itself, entitle the company to take the reserve as a deduction. The reserve disallowed by the court in Helvering v. Illinois Life Insurance Co., supra, was created out of premiums and improved with part of the company's interest earnings.

We think the portion of the legislative history of the Revenue Bill of 1932 referred to by plaintiff in support of its arguments on the interest content of the health and accident reserves here in issue has no important bearing upon the question whether such reserves are deductible. The part relied upon only explains the reason due to the decline in interest rates for changing the deduction on account of the reserves required by law within the meaning of the taxing statutes from 4 to 3½ per centum.

Finally plaintiff contends on this issue that a deduction should be allowed on account of reserves for health and accident insurance because of the prior regulations and practice of the Treasury Department under which such reserve deductions have been allowed until recently, when the

Treasury Department began to disallow deductions on account of reserves for "Disabled Lives." The past regulations and practice of the Treasury Department with reference to reserve deductions have not been entirely consistent. The regulations and practice in existence subsequent to January 1920 [15] and prior to Treasury Decision 4615, December 18, 1935 (33 T. D. 288), were not in harmony with the decisions of the Supreme Court hereinbefore cited. Although departmental regulations and practice will, in a [fol. 67] proper case, be given great weight, they cannot abridge the law and they can only stand if they correctly interpret the statute. As was said by the court in Koshland v. Helvering, 298 U. S. 441, 445, "The question here, however, is not merely of our adopting the administrative construction but whether it should be adopted if in effect it converts an income tax into a capital levy." Similarly the question here is whether the past practice relied upon by plaintiff has permitted deductions to be taken by a life insurance company which are not allowable under the statute. Compare M. E. Blatt Co. v. United States, — U. S. — (decided December 5, 1938). Inasmuch as deductions from gross income are matters of grace, only those items which clearly come within the class to which the particular statutory provision relates may be allowed. There is no room for implications or inferences, except as they are inevitable from the context. The rule that statutes levying taxes may not be extended by implication beyond the clear import of the language used nor their operations enlarged so as to embrace matters not specifically pointed out applies with equal or greater force to the determination and allowance of deductions. Helvering v. Stockholms Enskilda Bank, 293 U. S. 84, 87, 91, 93. Cf. United States v. Pleasants, — U. S. —, decided January 3, 1939 (86 C. Cls. 679).

The present regulations as amended by T. D. 4615, supra, are not inconsistent with our conclusion that health and accident reserves are not deductible by a life insurance company. The regulations, as so amended, provide, in effect, that for the purpose of the deduction by a life insurance

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[15] The date of the decision in Maryland Casualty Co. v. United States, 251 U. S. 342. See Continental Assurance Co., Inc. v. United States, 79 C. Cls. 756, 768. Massachusetts Mutual Life Insurance Co. v. United States, 74 C. Cls. 162, 166-171, 56 Fed. (2d) 897.

company the reserve contemplated does not include reserves not involving life contingencies.

We are of opinion that plaintiff is not entitled to recover and the petition must be dismissed. It is so ordered.

Whaley, Judge; Williams, Judge; Green, Judge; and Booth, Chief Justice, concur.

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[fol. 68] V. JUDGMENT

At a Court of Claims held at the City of Washington on the 6th day of March, A. D., 1939, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is not entitled to recover.

It is Therefore Adjudged and Ordered that the plaintiff's petition be and the same is hereby dismissed.

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VI. PROCEEDINGS AFTER ENTRY OF JUDGMENT

On May 5, 1939, the plaintiff filed a motion for a new trial.

On May 29, 1939, the court entered the following order on said motion:

Order

It is Ordered this 29th day of May, 1939, that the plaintiff's motion for new trial be and the same is hereby overruled.

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[fol. 69] Clerk's Certificate to foregoing transcript omitted in printing.

NUMBER 0000

✓ Stipulation Exhibit A

AGE 35

# New World

AMOUNT $1,000.00

PREMIUM $ 36.30

# Life Insurance Company

[redacted]

HEREBY PROMISES AND AGREES TO PAY

ONE THOUSAND Dollars,
the Principal Sum Insured,

to JOHN DOE, the Insured;

of SEATTLE, County of KING, State of WASHINGTON,

if living on the FIRST day of MAY, 1982, and this Policy

is then in force; or, to MARY DOE, WIFE of
the Insured, or to such other Beneficiary as may be duly designated as provided herein, immediately upon receipt of due proof of the death of said Insured, subject to the terms and provisions of this Policy.

This Policy is free from conditions as to Residence, Travel, or Place of Death.

This Insurance is granted in consideration of the application herefor, which is hereby made a part of this

Contract, and the payment of Thirty-six & 30/100 Dollars,

upon the First day of May, 1932

as the premium to provide the Legal Reserve and Term Insurance for one year from the date hereof, and of the further payment of

Thirty-six & 30/100 Dollars,

upon the First day of May

in each and every year thereafter until premiums for Twenty full years in all shall have been paid, or until the prior death of the Insured.

The privileges, benefits and provisions printed and written on the following pages by the Company are made a part of this Contract, as fully as if they were recited at length over the signatures hereto affixed. Unless otherwise herein especially stipulated, the first policy year shall begin on the date stated next below but in no case shall this Policy take effect until approval of the application therefor by the Company and until the payment of the first premium, both during the good health of the applicant.

In Witness Whereof, NEW WORLD LIFE INSURANCE COMPANY has caused this

Policy to be signed as of the First day of May, 1932

SECRETARY

John Flanigan
PRESIDENT

APPLICATION APPROVED BY RISK COMMITTEE
[illegible] 1932

# New World Life Insurance Company

AMOUNT $1,000.00

PREMIUM $ 36.30

[redacted]

HEREBY PROMISES AND AGREES TO PAY

[redacted] ONE THOUSAND [redacted] Dollars,
the Principal Sum Insured,

to [redacted] JOHN DOE [redacted], the Insured;

of [redacted] SEATTLE [redacted], County of [redacted] KING [redacted], State of [redacted] WASHINGTON [redacted],

if living on the [redacted] FIRST [redacted] day of [redacted] MAY [redacted], 1982 [redacted] and this Policy

is then in force; or, to [redacted] MARY DOE, WIFE [redacted] of the Insured, or to such other Beneficiary as may be duly designated as provided herein, immediately upon receipt of due proof of the death of said Insured, subject to the terms and provisions of this Policy.

This Policy is free from conditions as to Residence, Travel, or Place of Death.

This Insurance is granted in consideration of the application herefor, which is hereby made a part of this Contract, and the payment of [redacted] Thirty-six & 30/100 [redacted] Dollars,

upon the First day of [redacted] May, 1932 [redacted]

as the premium to provide the Legal Reserve and Term Insurance for one year from the date hereof, and of the further payment of

[redacted] Thirty-six & 30/100 [redacted] Dollars,

upon the First day of [redacted] May [redacted]

in each and every year thereafter until premiums for [redacted] Twenty [redacted] full years in all shall have been paid, or until the prior death of the Insured.

The privileges, benefits and provisions printed and written on the following pages by the Company are made a part of this Contract, as fully as if they were recited at length over the signatures hereto affixed. Unless otherwise herein especially stipulated, the first policy year shall begin on the date stated next below but in no case shall this Policy take effect until approval of the application therefor by the Company and until the payment of the first premium, both during the good health of the applicant.

In Witness Whereof, NEW WORLD LIFE INSURANCE COMPANY has caused this Policy to be signed as of the [redacted] First [redacted] day of [redacted] May [redacted], 19 32

SECRETARY

PRESIDENT

APPLICATION APPROVED BY RISK COMMITTEE
DATE May 1, 1932

NON-PARTICIPATING.

50 YEAR ENDOWMENT MATURING AT AGE 85 (PREMIUMS PAYABLE FOR 20 YEARS).

TOTAL AND PERMANENT DISABILITY
AND ACCIDENTAL DEATH BENEFITS

## ASSIGNMENT

Any assignment of this Policy must be made and sent to the Home Office of the Company in duplicate, one copy to be retained by the Company and the other returned to the Insured. The Company assumes no responsibility for the validity of any assignment.

## CHANGE OF BENEFICIARY; RIGHTS OF INSURED

The Insured may change any designated Beneficiary at any time during the continuance of this Policy, provided it is not then assigned, by filing with the Company a written request therefor accompanied by this Policy; such change to take effect upon the endorsement of the same on the Policy by the Company, whereupon all interest of the former Beneficiary shall cease. If no Beneficiary shall survive the Insured, the Policy shall be payable to the Insured's executors, administrators, or assigns.

This Policy is issued with the express understanding that the Insured may, without the consent of the Beneficiary, receive every benefit, exercise every right, and enjoy every privilege conferred upon him by this Policy.

## FOR HOME OFFICE ENDORSEMENT ONLY

## REGISTER OF CHANGE OF BENEFICIARY

NOTE—No change, designation or declaration shall take effect until endorsed on this Policy by the Company at the Home Office.

| DATE ENDORSED | BENEFICIARY | ENDORSED BY |
|---|---|---|
| | | |
| | | |
| | | |
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| | | |
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# General Privileges, Benefits and Provisions.

### Premiums

All premiums are due and payable in advance at the Home Office of the Company, [redacted] Washington, or, at the pleasure of the Company, to a designated Collector, but in any case only in exchange for the Company's receipt therefor, signed by the President or Secretary, and countersigned by such Collector.

If any premium is not paid when due, this Policy shall be null and void and all premiums forfeited to the Company, except as herein otherwise provided.

### Grace

A grace of one month, (not less than thirty days) will be allowed for the payment of all premiums after the first during which period this Policy shall remain in full force.

### Notice

Notice of premiums coming due will be sent to the Insured but the Company assumes no responsibility for the miscarriage or non-delivery of any notice.

### Authority of Agents

No Agent has power on behalf of the Company to make or modify contracts, to extend the time of payment of premium, to waive any forfeiture, to bind the Company by making any promise or representation, or to deliver any policy contrary to the provisions thereof. These powers can be exercised only by the President or Vice-President, and Secretary or Assistant Secretary, of the Company (and then only in writing), and will not be delegated.

### Contract: Incontestability

This Policy and the application therefor, a copy of which is attached hereto, constitute the entire contract between the parties hereto, and shall be incontestable after two years from date except for non-payment of premiums and except as to any provisions and conditions relating to Disability and Accidental Death Benefits; provided, however, that

### Military and Naval Service

In the event of the death of the Insured at any time during the life of this Contract and while engaged in Military, Naval, or Aerial Service (as a part thereof) in time of war, without first having obtained written permission from the Company, the Company's liability hereunder shall be limited to the amount of premiums paid hereunder;

### Suicide

Provided, however, that in the event of the death of the Insured by his own act, whether sane or insane, within two years from the date of this Policy, the Company's liability hereunder shall be limited to the amount of premium paid hereon.

### Representations

All statements of the Insured shall, in the absence of fraud, be deemed representations and not warranties, and no such statement shall avoid the Policy unless it is contained in the written application, and a copy of such application shall be endorsed hereon or attached hereto.

### Age

If the age of the Insured has been misstated, the amount payable under this Policy shall be such as the premium paid would have purchased at the correct age.

### Indebtedness

Upon any settlement under this Policy, all indebtedness to the Company on the Policy and also, in the event of death, any unpaid portion or installment of the full premium for the current policy year, shall be deducted from any sum payable by the Company.

### Reinstatement

After default in the payment of any premium and unless previously surrendered, this Policy may be reinstated at any time upon the production of evidence of insurability satisfactory to the Company, and the payment of all past due premiums with interest thereon at the rate of six per centum per annum from their respective due dates;—provided, that any indebtedness to the Company upon this Policy existing at the date of such default, together with compound interest thereon to the date of reinstatement, at the rate of six per centum per annum, shall be a first lien upon the Policy if not paid in cash at the date of reinstatement of the Policy.

### Cash Loans

At any time after the payment of premiums for three full years and while this Policy is in force, the Company will loan upon proper assignment of this Policy, and upon the sole security thereof, all or any part of the sum stated in Column 1 of the Table of Loan and Non-forfeiture Values herein, subject to the deduction of all premiums for the current policy year and all existing indebtedness to the Company on the Policy. This loan shall bear interest at the rate of six per centum per annum, payable in advance to the end of the current policy year and annually thereafter, and may be deferred for not exceeding ninety days, unless made for the purpose of paying a premium hereon. Failure to repay any such loan, or to pay the interest thereon, shall not avoid the Policy until the total indebtedness to the Company shall equal or exceed the loan value nor until one month after notice has been mailed by the Company to the last known address of the Insured and of the Assignee, if any.

### Premium Loans

Loans to pay premiums will be made (if written request therefor shall have been included in the application for this Policy, or if filed by the Insured at the Home Office of the Company before default in the payment of any premium) as follows:

If any premium hereon is not paid when due after the Policy shall have been in force for three full years, the Company will, without further action by the Insured, charge the amount of premium then due hereunder as a loan against the Policy, with interest in advance at the rate of six per centum per annum, if the Cash Value of this Policy at the end of the period which such premium would cover is sufficient to secure all indebtedness hereon, including such unpaid premium, with interest as above. The same benefit will be applied from time to time, as premiums become due hereunder and are not paid, as long as the available Cash Value is sufficient to pay for one day's insurance. The Insured may resume the payment of premiums hereon at any time without medical examination, while the Policy is so continued in force by such Premium Loans. The indebtedness hereunder will be subject to the provisions relating to repayment stated under Cash Loans, above. The Insured may at any time revoke the request for Premium Loans by filing a written revocation with the Company at its Home Office.

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## TABLE OF LOAN AND NON-FORFEITURE VALUES

The values in the Table below apply only if there be no indebtedness under this Policy, and apply only to completed policy years. If default occurs after a fractional part of the current policy year's premium has been paid, the non-forfeiture values provided for below shall be adjusted proportionately.

| YEARS Premiums PAID | CASH OR LOAN (Column 1) | PAID-UP ENDOWMENT INSURANCE (Column 2) | PAID-UP TERM AND PURE ENDOWMENT (Column 3) | | | YEARS Premiums PAID | CASH OR LOAN (Column 1) | PAID-UP ENDOWMENT INSURANCE (Column 2) | PAID-UP TERM AND PURE ENDOWMENT (Column 3) | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Yrs. | Days | Pure Endowm't | | | | Yrs. | Days | Pure Endowm't |
| 3 | 43 | 108 | 4 | 343 | -- | 13 | 313 | 640 | 22 | 360 | -- |
| 4 | 66 | 163 | 7 | 223 | -- | 14 | 345 | 690 | 23 | 324 | -- |
| 5 | 89 | 216 | 10 | 48 | -- | 15 | 379 | 741 | 24 | 312 | -- |
| 6 | 114 | 271 | 12 | 219 | -- | 16 | 414 | 792 | 25 | 321 | -- |
| 7 | 139 | 323 | 14 | 258 | -- | 17 | 451 | 844 | 27 | 44 | -- |
| 8 | 166 | 378 | 16 | 234 | -- | 18 | 489 | 896 | 28 | 243 | -- |
| 9 | 193 | 430 | 18 | 85 | -- | 19 | 528 | 947 | 30 | 338 | -- |
| 10 | 221 | 482 | 19 | 224 | -- | 20 | 569 | 1000 | PAID | UP | -- |
| 11 | 251 | 536 | 20 | 326 | -- | 25 | 631 | 1000 | | | |
| 12 | 281 | 587 | 21 | 349 | -- | 30 | 694 | 1000 | | | |

20 E85-1000-35

The above options are all of equal value and are based upon the Reserves on this Policy, at the end of policy years, with a surrender charge in no case of more than two and one-half per centum of the face of this Policy. The Reserve on this Policy shall be computed upon the basis of the American Experience Table of Mortality with interest at the rate of three and one-half per centum per annum and by the Illinois Standard Method. Values for years not shown will be furnished upon request, and will be equal to the entire Reserve under this Policy according to the aforesaid Table and interest rate.

## NON-FORFEITURE AND SURRENDER OPTIONS

If default shall be made in the payment of any premium after payment of premiums for three years, if there be no indebtedness to the Company under this Policy, the Insured shall be entitled to one of the following options; **All of Equal Value:**

(a) Without any action on the part of the Insured, and without the payment of further premiums, this Policy will be continued as Paid-up Term Insurance for its Principal Sum, for the term specified in Column 3 of the Table above, (or the extension thereof for years not shown) such term to be reckoned from the due date of the unpaid premium; and, if such term extends to the end of the endowment period, with the Pure Endowment specified payable to the Insured, if living, at the end of such term; OR,

(b) Upon written application of the Insured therefor, made to the Company at its Home Office within sixty (60) days from the date of such default, the Company, on legal surrender of this Policy, will issue in exchange therefor a Paid-up Endowment Policy for the amount specified in Column 2 of said Table and payable at the same time as is this Policy; OR,

(c) If this Policy be legally surrendered to the Company at its Home Office within sixty (60) days from the date of such default, the Company will pay therefor in cash, the sum stated in Column 1 of said Table. The payment of such Cash Value may be deferred by the Company for a period of not exceeding ninety days.

If there be any indebtedness to the Company under this Policy, the values in the said Table above shall be reduced in the following manner:

(d) From the Cash Value, provided for in Paragraph (c) above, shall be deducted such indebtedness and the excess of said Cash Value over said indebtedness shall, without any action on the part of the Insured, be applied to the purchase of Paid-up Term Insurance for this Policy's Principal Sum and for such term, to be reckoned from the due date of the unpaid premium, as the said excess will purchase at the Insured's then attained age at net single premium rates, according to the American Experience Table of Mortality and 3½ per centum interest. Should such excess be more than sufficient to provide such insurance to the end of the endowment period, the balance, after providing such insurance, shall be applied at net single premium rates by the Mortality Table and interest rate aforesaid, to the purchase of a Pure Endowment payable to the Insured, if living at the end of such period; OR,

(e) Upon written application of the Insured, made therefor to the Company at its Home Office within sixty (60) days from such default, and upon legal surrender of this Policy, such excess shall be applied to the purchase of a Paid-up Endowment Policy, payable at the same time as is this Policy, for such amount as the excess above referred to will purchase at the Insured's then attained age at net single premium rates according to the Mortality Table and interest rate aforesaid; OR,

(f) If this Policy be legally surrendered to the Company within sixty (60) days from such default, the Company will pay therefor in cash the excess above referred to.

The Paid-up Term Insurance and Pure Endowment, if any, or the Paid-up Endowment Policy, provided for above, will be entitled to cash surrender values based upon the entire reserve thereon at the time of surrender, according to the above Mortality Table and rate of interest, less any indebtedness to the Company.

## OPTIONS AT MATURITY

At the end of the Endowment Period the Insured shall have the choice of the following options:

1st. Surrender this Policy and receive in exchange therefor $ 1000.00, OR,

2nd. Surrender this Policy and receive in exchange therefor a Paid-up Life Policy for $ 1000.00, and $ 104.00 in cash, OR,

3rd Surrender this Policy and receive in exchange therefor a Paid-up Life Policy for $ 1116.00

Options 2 and 3 above are subject to evidence of insurability satisfactory to the Company

# Installment and Trust Fund Privileges.

### Installment Benefits

At any time when this Policy shall be in force and not assigned or pledged, the Insured may change the mode of payment thereof as a death claim, from payment in one sum, as provided on the first page, to payment by monthly installments, as stated below. In such case any installments maturing after the death of the Beneficiary shall be payable to the executors, administrators, or assigns of the Beneficiary.

The following Tables are based upon a Policy of $1,000, and the amounts shown thereby are to be increased proportionately for larger Policies. These installment benefits do not apply to Policies of less than $1,000.

### Limited Installments

Monthly installments limited to the number selected.

Any number from twelve to three hundred may be selected by the Insured.

| Number of Installments | Amount of Each Installment | Number of Installments | Amount of Each Installment |
|---|---|---|---|
| 300 | $4.96 | 144 | 8.46 |
| 288 | 5.09 | 132 | 9.09 |
| 276 | 5.24 | -120- | 9.84 |
| 264 | 5.39 | 108 | 10.75 |
| 252 | 5.57 | 96 | 11.90 |
| -240- | *5.76 | 84 | 13.38 |
| 228 | 5.97 | 72 | 15.35 |
| 216 | 6.20 | -60- | 18.12 |
| 204 | 6.47 | 48 | 22.27 |
| 192 | 6.76 | 36 | 29.20 |
| -180- | 7.10 | 24 | 43.06 |
| 168 | 7.49 | 12 | 84.65 |
| 156 | 7.94 | | |

*Illustration: If payment is to be made by 240 installments, the amount of each will be $5.76 for each $1,000 of insurance.

### Trust Fund Privileges

The amount payable as a death claim under this Policy, if $1,000 or more, may be placed in trust with the Company. During the continuance of such trust, interest at the rate of three and one-half per centum per annum will be paid thereon to the Beneficiary. The payment of the first installment of interest will be made one year from the date of death of the Insured. At the termination of the trust the principal sum will be paid to the Beneficiary or to his executors, administrators, or assigns in event of the death of the Beneficiary prior to such termination.

Each installment payable during the specified number of years under the Limited and Continuous Installment provisions above or each payment of interest under the Trust Fund Privilege, may be increased by such amount from the interest earnings of the Company as may be apportioned from time to time by the Company.

### Continuous Installments

Installments to continue during the entire life of the Beneficiary; two hundred forty monthly installments guaranteed.

(Payments by continuous installments cannot be selected if there be more than one beneficiary.)

| Age of Beneficiary at Death of Insured | Amount of Each Installment | Age of Beneficiary at Death of Insured | Amount of Each Installment |
|---|---|---|---|
| 10 | $3.63 | 41 | 4.52 |
| 11 | 3.65 | 42 | 4.57 |
| 12 | 3.66 | 43 | 4.62 |
| 13 | 3.68 | 44 | 4.67 |
| 14 | 3.69 | -45- | 4.72 |
| -15- | 3.71 | 46 | 4.78 |
| 16 | 3.73 | 47 | 4.83 |
| 17 | 3.74 | 48 | 4.89 |
| 18 | 3.76 | 49 | 4.95 |
| 19 | 3.78 | -50- | 5.00 |
| -20- | 3.80 | 51 | 5.06 |
| 21 | 3.83 | 52 | 5.11 |
| 22 | 3.85 | 53 | 5.16 |
| 23 | 3.87 | 54 | 5.22 |
| 24 | 3.90 | -55- | 5.27 |
| -25- | 3.92 | 56 | 5.31 |
| 26 | 3.95 | 57 | 5.36 |
| 27 | 3.98 | 58 | 5.40 |
| 28 | 4.00 | 59 | 5.44 |
| 29 | 4.04 | -60- | 5.48 |
| -30- | *4.07 | 61 | 5.51 |
| 31 | 4.10 | 62 | 5.54 |
| 32 | 4.14 | 63 | 5.57 |
| 33 | 4.17 | 64 | 5.59 |
| 34 | 4.21 | -65- | 5.61 |
| -35- | 4.25 | 66 | 5.62 |
| 36 | 4.29 | 67 | 5.64 |
| 37 | 4.33 | 68 | 5.65 |
| 38 | 4.38 | 69 | 5.65 |
| 39 | 4.42 | -70- | 5.66 |
| -40- | 4.47 | and over | |

*Illustration: Under a policy for $1,000, if, at the death of the Insured, the Beneficiary were 30 years of age at last birthday, the amount of each monthly installment would be $4.07, payable at least during the entire life of the Beneficiary. If the Beneficiary should die before 240 installments had been paid, the remainder of the 240 installments would be payable monthly to the executors, administrators, or assigns of the Beneficiary.

At any time when this Policy shall be in force and not assigned, the Insured may revoke any selection of installment benefits theretofore made.

No selection, change, or revocation shall be made except upon written direction of the Insured, or take effect until endorsed on this Policy by the Company at its Home Office.

The first installment shall be paid upon receipt by the Company at its Home Office of due proofs of the death of the Insured, and subsequent installments shall be paid monthly thereafter.

The Beneficiary can neither assign nor commute unpaid installments, unless such right be given expressly by the Insured to the Beneficiary in his written direction for payment by installments.

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## TOTAL AND PERMANENT DISABILITY BENEFITS

Upon receipt and approval at the Company's Home Office, while this Policy and this Disability Provision are in full force, and before the default in the payment of any premium under this Policy or this Provision, of due proof that the Insured is totally disabled as defined in the Paragraph below entitled "Definition of Total Disability", such proof to show that such Total Disability has existed continuously for at least four months (such Disability of such duration being deemed to be permanent only for the purpose of determining the commencement of liability hereunder) the Company will grant the following Benefits:

**Waiver of Premium.** The Company will waive the payment of each premium under this Policy, beginning with that premium the due date of which next succeeds the date of commencement of such Disability; provided, however, that no premium shall be waived the due date of which is more than one year prior to the date of receipt at the Home Office of the Company of written notice of claim hereunder; and

**Disability Income.** Pay to the Insured, or if such disability is due to or is accompanied by mental incapacity, to the Beneficiary of record under this Policy, a monthly income of Ten - - - - - - - - - - - - - - - - Dollars, such monthly income to be paid for each completed month of such continuous Disability beginning with the fourth such month; provided, however, that in no case shall any such monthly income be paid for the first three months of such Disability nor for any fractional part of a month of such Disability, nor for any period of Disability more than one year prior to the date of receipt at the Home Office of the Company of written notice of claim hereunder. Any income payment due but unpaid at the time of the Insured's death shall be payable to the person entitled to the proceeds of this Policy.

Any premiums so waived and any Disability Income so paid shall not be deducted from any other amount payable in any settlement of this Policy. Loan, surrender and non-forfeiture values shall be the same as though the premiums waived had been duly paid.

**Definition of Total Disability.** DISABILITY shall be considered TOTAL when the Insured is so disabled as the result of bodily injuries or disease that he is wholly prevented from performing any work, from following any occupation, or from engaging in any business for remuneration or profit; provided such Disability had its inception after the insurance under this Policy took effect and prior to the anniversary date of this Policy on which the Insured's age at nearest birthday is sixty. THE TOTAL AND IRRECOVERABLE LOSS OF THE SIGHT OF BOTH EYES OR THE SEVERANCE OF BOTH HANDS AT OR ABOVE THE WRISTS, OR OF BOTH FEET AT OR ABOVE THE ANKLES, OR SUCH SEVERANCE OF ONE ENTIRE HAND AND OF ONE ENTIRE FOOT, SHALL BE DEEMED TOTAL DISABILITY HEREUNDER.

The DISABILITY BENEFITS herein provided shall not be payable if the DISABILITY of the Insured shall have resulted from self-inflicted injury, from bodily injuries sustained by the Insured while participating in aviation or aeronautics, except as a fare paying passenger on a licensed aircraft operated by a licensed pilot, or sustained while the Insured is in the Military, Naval or Aerial Service (as a part thereof) in time of war; nor shall DISABILITY BENEFITS be included in any Paid-up Term Insurance or other Paid-up Benefit granted upon surrender or lapse of this Policy or at any other time or under any other conditions.

The provision hereunder for DISABILITY BENEFITS shall be suspended while the Insured is in the Military, Naval or Aerial Service (as a part thereof) in time of war, in which event that portion of the premium for this DISABILITY BENEFIT unearned during the period of such suspense shall be refunded.

Written notice of claim hereunder must be received at the Home Office of the Company during the life-time of the Insured and the continuance of such TOTAL DISABILITY. Failure to give notice as herein provided shall not invalidate any TOTAL DISABILITY claim if it shall be shown not to have been reasonably possible to give such notice and that written notice was given as soon as was reasonably possible.

Due proof of such TOTAL DISABILITY must be received at the Home Office of the Company while this Policy and this DISABILITY PROVISION are in force and before the expiration of one year after default in the payment of any premium, or if there shall have been no such default, not later than one year from the date of maturity of this Policy.

If due proof furnished as required above shall establish that such TOTAL DISABILITY commenced during the grace period of a premium in default, the due date of which premium was within a period of one year prior to receipt of notice of claim hereunder, DISABILITY BENEFITS shall be allowed as if such default had not occurred, provided such premium in default be paid to the Company together with interest thereon at the rate of six per centum per annum. Such premium and interest may be deducted from any amounts payable under this Policy or this DISABILITY PROVISION.

The Company shall have the right at any time during the first two years after receipt of such proof, and thereafter once a year, to require proof of the continuance of such TOTAL DISABILITY. If satisfactory proof is not furnished, or if it appears at any time that such TOTAL DISABILITY has terminated, no further premiums will be waived and no further DISABILITY INCOME payments will be made on account of such TOTAL DISABILITY.

This DISABILITY PROVISION shall forthwith terminate if any premium on this Policy or any premium payable for this DISABILITY PROVISION is not paid on its due date or within the days of grace unless waived in accordance with this DISABILITY PROVISION; or if the insurance under this Policy shall cease for any other reason.

The annual premium for the DISABILITY BENEFITS provided for herein is $ 4.31. Upon the due date of any premium called for by this Policy this DISABILITY PROVISION may be discontinued by returning this Policy to the Company for proper endorsement, the Policy to be accompanied by a written request, satisfactory to the Company, for such discontinuance, and thereafter the payment of the premium charged for this DISABILITY PROVISION shall not be required and the annual premium under this Policy shall be reduced to $ 31.99. In no event shall a premium be charged for this DISABILITY PROVISION on or after the anniversary of this Policy's date on which the Insured's age at nearest birthday is sixty years.

## ACCIDENTAL DEATH BENEFITS

**Death from Accident.** If, during the premium paying period of this Policy, and before the anniversary of this Policy upon which the Insured's age at nearest birthday is sixty, the death of the Insured shall result, directly and independently of all other causes, from bodily injuries effected solely through external, violent and accidental means, within ninety days from the occurrence of the accident occasioning such injuries, the Company will pay, in addition to the face amount of this Policy, the sum of $ 1,000.00

**Death from Travel Accident.** In lieu of the Accidental Death Benefits provided for in the above Paragraph entitled "Death From Accident", if, during the premium paying period of this Policy, and before the anniversary of this Policy upon which the Insured's age at nearest birthday is sixty, the death of the Insured shall result, directly and independently of all other causes, from bodily injuries effected solely through external, violent and accidental means, while traveling as a passenger on a licensed public conveyance operated by an incorporated common carrier for the regular transportation of passengers, submarine or aeronautic travel not included, within ninety days from the occurrence of the accident occasioning such injuries, the Company will pay, in addition to the face amount of this Policy, the sum of $2,000.00

Provided, however, and the payment of any additional sum under either of the above clauses entitled "Death From Accident" or "Death From Travel Accident" is upon these express conditions: that at the time of the occurrence of the accident from which death resulted, and of death, all premiums under this Policy had been duly paid to the date of such accident and death, this Policy was in full force and effect, and no disability benefit had been granted hereunder; that there is a visible contusion or wound on the exterior of the body caused by the infliction of such injuries, save where death results from drowning or internal injuries are disclosed by an autopsy; that neither injuries nor death resulted directly or indirectly, from suicide or an attempt to commit suicide whether sane or insane, or from disease or bodily or mental infirmities; and that neither injuries nor death resulted from nor were in any way, directly or indirectly induced by: (a) Violation of or resistance to the law by the Insured; (b) Military or Naval Service; (c) Red Cross or other relief or welfare work in connection with actual warfare; (d) a state of warfare, riot, or insurrection; (e) participation in aeronautic or submarine operation (f) engaging in mining or any underground operations.

Accidental Death Benefits shall not be included in any Paid-up Term Insurance or other Paid-up Benefit granted upon surrender or lapse of this Policy or at any other time or under any other conditions.

These provisions for Accidental Death Benefits become null and void on the anniversary of this Policy upon which the Insured's age at nearest birthday is sixty or upon default in the payment of any premium under this Policy.

The annual premium for the Accidental Death Benefits provided herein is $ 2.00. Upon written request by the Insured, accompanied by this Policy for endorsement, the clauses entitled "Accidental Death Benefits" herein will be cancelled by the Company and premiums thereafter falling due under this Policy will be reduced to $ 34.30; or, upon the anniversary of this Policy upon which the Insured's age at nearest birthday is sixty the premiums thereafter falling due under this Policy will be so reduced.

CUT ON THIS LINE

☞ (RECEIPT FOR THE CURRENT YEAR'S PREMIUM MUST ACCOMPANY THIS DRAFT) ☜

# Emergency Draft

Dated at _____

At sight pay to
the order of myself, ONE HUNDRED - - - - - - - - - - - - - - - DOLLARS

and charge against any claim that may arise under Policy No. 0000 issued by

**New World Life Insurance Company, of Seattle, Washington**

to John Doe - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - - (Deceased)

It is hereby understood that the payment of the above amount is a loan to the Beneficiary, made in consideration of the death of the Insured, and the acceptance and the payment hereof shall not be considered as an acknowledgment, by the Company, of the validity of any claim by reason of said policy.

TO NEW WORLD LIFE INS. COMPANY,
SEATTLE, WASHINGTON

_____
Beneficiary

I hereby certify that the insured under this policy is deceased, and that the deceased did not commit suicide.

_____
PRESIDENT—CASHIER

DATED _____ _____
(INSERT NAME OF BANK)

**TO THE BENEFICIARY**

In the event of the death of the Insured, take this policy together with all receipts and other papers in relation thereto, to your banker. Receipt for the current year's premium must accompany the draft.

The death of the Insured must be certified to by the President or Cashier of a bank. Upon its receipt properly executed, this draft will be honored for an amount not exceeding the per centum of amount of this policy.

Received from New World Life Insurance Company _____ Dollars
_____ 19__
in full of all claims under this Policy, and said Policy is hereby surrendered for cancellation.

_____

_____

_____

_____

Witness _____

5 YEAR ENDOWMENT MATURING AT AGE 85
(PREMIUMS PAYABLE FOR 20 YEARS).
NON-PARTICIPATING.

CASH AND PAID-UP VALUES.
SEE BACK PAGE.

POLICY AND RIDER

SOLD

# New World

## Life Insurance Company

HOME OFFICE

NAME OF INSURED

John Doe

AMOUNT $1000.00

PREMIUM $36.30

DATE OF

POLICY May 1, 1922

NOTIFY COMPANY OF ANY CHANGE IN POST OFFICE ADDRESS.

In case of any question relative to this Policy write direct to the Company. It is not necessary to employ any person, firm or corporation to collect the insurance or to secure any benefit under this Policy.

FORM 5 AM-D-1920

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[fol. 78] IN SUPREME COURT OF THE UNITED STATES

JOINT STIPULATION OF COUNSEL THAT THE PRINTING OF STIPULATION EXHIBITS "A", "B" AND "C" BE DISPENSED WITH IN THIS COURT—Filed Sept. 28, 1939

Since Stipulation Exhibit A and Stipulation Exhibit B, certified by the Clerk below as Exhibits A and B, respectively, and by reference made a part of the findings by the Court below (R. 29, 30), are copies of letters of final determination by the Commissioner of Internal Revenue of petitioner's income tax liabilities for the taxable years 1929 and 1930, and 1931 and 1932, respectively; and since Stipulation Exhibit C, certified by the Clerk below as Exhibit C and by reference made a part of the findings by the Court below (R. 31), is a statement showing the amount of cash transactions by petitioner's branch offices in the underwriting and investment departments, respectively, for 1931 and 1932; and since the printing of said Stipulation Exhibit A, Stipulation Exhibit B and Stipulation Exhibit C, certified, as aforesaid, by the Clerk below as Exhibit A, Exhibit B and Exhibit C, respectively, does not appear to be necessary for [fol. 79] this Honorable Court to reach a proper understanding of the issues involved in the within cause, and the printing thereof would result in an unnecessary cost to the petitioner herein;

It is agreed that, with the permission of this Honorable Court, which is hereby prayed for, the printing of said Stipulation Exhibit A, Stipulation Exhibit B and Stipulation Exhibit C, certified by the Clerk below as Exhibit A, Exhibit B and Exhibit C, respectively, be dispensed with.

This is signed in duplicate.

Walter E. Barton, Investment Building, Washington, D. C., Counsel for Petitioner. Robert H. Jackson, Solicitor General of the United States, Counsel for Respondent.

[fol. 79½] [File endorsement omitted.]

[fol. 80] IN SUPREME COURT OF THE UNITED STATES

ORDER EXTENDING TIME WITHIN WHICH TO APPLY FOR WRIT OF CERTIORARI

On consideration of the motion of counsel for petitioner in the above-entitled cause, and good cause therefor having been shown,

It is Now Here Ordered that the time within which petition for writ of certiorari may be filed herein be, and the same is hereby, extended until and including October first, 1939.

Wm. O. Douglas, Associate Justice of the Supreme Court of the United States.

Dated this 11th day of August, 1939.

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Endorsed on cover: Enter Walter E. Barton. File No. 43,824. Court of Claims. Term No. 417. New World Life Insurance Company, Petitioner, vs. The United States. Petition for a writ of certiorari and exhibit thereto. Filed September 25, 1939. Term No. 417, O. T., 1939.

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[fol. 81] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—May 20, 1940

On Petition for Writ of Certiorari to the Court of Claims.

A petition for rehearing having been submitted in this case;

Upon consideration thereof, it is ordered by this Court that the petition for rehearing be, and the same is hereby, granted.

And it is further ordered that the order denying certiorari entered November 22. 1939, be, and the same is hereby, vacated; and that the petition for writ of certiorari herein be, and the same is hereby, granted, limited to the second question presented thereby.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

Office - Supreme Court, U. S.
FILED
SEP 25 1939
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1939**

---

**No. 4[redacted] 2**

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NEW WORLD LIFE INSURANCE COMPANY,
A CORPORATION,
*Petitioner,*

*vs.*

THE UNITED STATES.

---

**PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF.**

---

WALTER E. BARTON,
*Washington, D. C.,*
*Counsel for Petitioner.*

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| Art. 681, Reg. 62 (1921 Act) | 19, 33 |
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| Art. 681, Reg. 69 (1926 Act) | 19, 33 |
| Art. 971, Reg. 74 (1928 Act) | 19, 32, 33, 35 |
| Art. 971, Reg. 77 (1932 Act) | 19, 32, 33, 35 |
| Art. 203 (a) (2)—1, Reg. 86 (1934 Act) | 19, 20, 33, 35 |
| Art. 203(a) (2)—1, Reg. 94 (1936 Act) | 20, 35 |
| Art. 203 (a) (2)—1, Reg. 101 (1938 Act) | 20, 35 |
| T. D. 4615 (December 18, 1935), C. B. XIV—2, pp. 310, 312 | 8, 20 |

SUPREME COURT OF THE UNITED STATES

**OCTOBER TERM, 1939**

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# No. 417

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NEW WORLD LIFE INSURANCE COMPANY,
A CORPORATION,
*Petitioner,*

*vs.*

THE UNITED STATES.

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## PETITION FOR WRIT OF CERTIORARI.

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*To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:*

Your petitioner, New World Life Insurance Company, respectfully submits its petition for a writ of certiorari to review the judgment of the Court of Claims of the United States in the above entitled case.

### Jurisdiction.

The judgment of the Court of Claims was entered on March 6, 1939 (R. 60). Motion for new trial was filed on May 5, 1939 (R. 60), and denied by the Court below on May 29, 1939 (R. 60). An extension of time until October

1, 1939 within which to file a petition for a writ of certiorari herein was granted by this Honorable Court on August 11, 1939 (R. 70). The jurisdiction of this Honorable Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939. (28 U. S. Code, § 288 (b); c. 229, § 3, 43 Stat. 939; U. S. Code Current Service (1939), No. 6, p. 835.)

**Nature of Controversy.**

This is a suit by the petitioner, a life insurance company, in the Court of Claims for the recovery of income taxes for the years 1929 to 1932, inclusive, after timely filing and rejection of claims for refund for said respective years.

The petitioner claimed a deduction for investment expenses under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932, of portions of total salaries paid to its officers and cashiers for services rendered in its investment department. For instance, if one-half of the total time of the officer or cashier was devoted to the investment department, one-half of the total salary paid to him was charged on the books and deducted in petitioner's income tax return as investment expenses. The Court of Claims held that the amount charged as investment expenses was an assignment of general expenses to investment expenses within the meaning of said section, and that it was not deductible (R. 45).

Another question was whether petitioner was entitled to a deduction under Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932 of the statutory percentage of the mean of Reserves for Total and Permanent Disability Benefits, Active Lives and Disabled Lives. The Court of Claims denied the deduction (R. 59-60).

**Statement of the Case.**

The material facts as found by the Court of Claims are as follows:

Petitioner is a stock life insurance company organized under the laws of the State of Washington. On November 22, 1929 petitioner's Board of Directors passed the following resolution, which was in effect during the taxable years 1929 to 1932, inclusive:

> "That in connection with office salaries paid, the Company's disbursements for such purposes during the year 1929 and in succeeding years, until by proper Board Resolution the ratios herein shall be changed, shall be charged as between Investment and Insurance expense in the following proportions:

| Name. | Investment. | Insurance. |
|---|---|---|
| John J. Cadigan (President) | 50% | 50% |
| Edward J. O'Shea (Treasurer) | 80% | 20% |
| Graves, Mizer & Graves (General Counsel) | 75% | 25% |
| R. L. McGinnis | 100% | |
| F. W. Maddux | 100% | |
| Cashier in Seattle Office | 25% | 75% |
| Cashier in Oakland Office | 50% | 50% |
| Cashier in Portland Office | 25% | 75% |
| Cashier in Los Angeles Office | 50% | 50% |
| Cashier in San Diego Office | 25% | 75% |
| All employees in home office Investment Department | 100% | |
| All employees in home office Policy Loan Department | 100%" | |

(R. 17, 24).

The percentages set forth in said resolution represented, in the case of officers, estimates arrived at by the respective officers, and in the case of cashiers, estimates arrived at by supervising officers in charge of such cashiers, after a careful consideration of the duties theretofore performed by such officers and cashiers, respectively, and which it was estimated they would perform in the future. The officers and cashiers, respectively, devoted at least as much of their time to the investment department of petitioner's business

for the taxable years involved as the percentages set forth in the resolution (R. 25).

Petitioner paid the following total salaries to its officers and cashiers for services rendered in both departments:

| | 1929. | 1930. | 1931. | 1932. |
|---|---|---|---|---|
| President | $18,000.00 | $18,000.00 | $18,000.00 | $18,000.00 |
| Treasurer | 8,500.00 | 9,875.00 | 10,000.00 | 10,000.00 |
| General Counsel | 1,800.00 | 1,800.00 | 3,112.50 | 5,619.08 |
| Office Cashiers[1] | ..... | 7,795.64 | 10,805.28 | 11,960.00 |

(R. 30.)

[1] Four in 1930 and five in 1931 and 1932.

Petitioner charged to its investment department and deducted as investment expenses in its income tax returns for 1929 to 1932, inclusive, amounts equal to the same percentages of the total salaries paid to its officers and cashiers, which said resolution provided should be charged as investment expenses; to wit:

| | |
|---|---|
| 1929 | $17,149.92 |
| 1930 | 21,387.58 |
| 1931 | 24,004.99 |
| 1932 | 26,559.43 |

(R. 18-22, 25).

The Commissioner disallowed the above deductions for salaries paid to petitioner's officers and cashiers for part-time services rendered in its investment department, but allowed other deductions for investment expenses, including salaries of officers and employees who devoted their entire time to the investment department, as follows:

| | |
|---|---|
| 1929 | $38,730.29 |
| 1930 | 41,197.85 |
| 1931 | 36,895.42 |
| 1932 | 32,016.95 |

(R. 18-23).

Petitioner writes non-participating policies of life insurance, such as straight life, twenty payment life, endow-

ment, etc., some of which also include provisions for total and permanent disability benefits and accidental death benefits. Petitioner issues some separate life policies but issues no separate disability and/or accidental death policies. Petitioner's life insurance contracts and its combined life, health and accident insurance contracts constitute all of the classes of insurance issued by it, all of which are written on the level premium plan (R. 17, 25-26).

On each policy covering combined life, health and accident insurance, the total premium shown on the face of the policy includes the life premium, the disability premium, and the accident premium, the last two of which are also stated separately elsewhere in the policy (R. 26).

The cancellation or termination of the life insurance automatically cancels or terminates the disability and accident insurance. The policyholder may discontinue the disability and/or accident insurance at any premium-paying date without discontinuing the life insurance, in which event the total premium shown on the face of the policy is correspondingly reduced (R. 26).

The disability and accidental death benefits are not included in any paid-up term insurance, or other paid-up benefits granted upon the surrender or lapse of the policy; nor does any reserve held on account thereof enter into the amount of the separate reserve held for the life insurance covered by the policy, or the surrender, cash or loan values shown in the "Table of Loan and Nonforfeiture Values" (R. 26).

A sample combined life, health and accident insurance policy issued on May 1, 1932, to John Doe at age 35, for $1,000.00, the same being non-participating, endowment at age 85, premiums payable for 20 years, and containing total and permanent disability and accidental death benefits, is in the record and marked "Stipulation Exhibit D" (R. 26, 61).

Petitioner sets up out of the life premiums, a separate life reserve, and out of the accident premiums, a separate reserve for accidental death benefits, neither of which is in controversy here. Petitioner also sets up a separate reserve out of the disability premiums, commonly known as Reserve for Total and Permanent Disability Benefits, Active Lives, hereinafter referred to as "Disability Reserve, Active Lives." This reserve relates to outstanding disability insurance in force with respect to which total and permanent disability has not occurred (R. 27, 29).

In calculating the disability premium, the rate of disability, the rate of mortality, the rate of interest, and the rate of expense are taken into consideration. The first three determine the net disability premium, which is the amount that in connection with a given number of lives will be exactly sufficient to pay all disability claims of the group, according to the adopted combined mortality and disability table (usually Hunter's Combined Table of Mortality and Disability), if it is invested immediately at the rate of interest assumed (usually 3 to 3½ *per centum* compound interest) (R. 28).

When a person carrying disability insurance becomes totally and permanently disabled, petitioner transfers a certain amount from its Disability Reserve, Active Lives to another reserve commonly called "Reserve for Total and Permanent Disability Benefits, Disabled Lives," hereinafter referred to as "Disability Reserve, Disabled Lives." The amount transferred is calculated upon the basis of selected tables of probabilities of length of disability and expected benefits (such as Hunter's Disabled Lives Mortality Table), improved with an assumed rate of interest (usually 3½ *per centum* compound interest), mortality also being taken into consideration. When a policyholder becomes totally and permanently disabled, it is not possible to determine the amount of the disability benefits likely to be-

come payable under the policy, due to the fact that disability payments cease upon the death of the disabled person, and also upon the discontinuance of his disability while living (R. 28-29).

The mean of petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives held at the beginning and end of the taxable years involved was:

| | Active Lives. | Disabled Lives. |
|---|---|---|
| 1929 | $78,562.76 | $60,994.28 |
| 1930 | 65,871.14 | 95,432.05 |
| 1931 | 68,593.97 | 123,439.49 |
| 1932 | 90,725.50 | 131,206.50 |

(R. 29, 30.)

Petitioner's Disability Reserve, Active Lives was computed in accordance with standard combined mortality and disability tables, and its Disability Reserve, Disabled Lives was computed in accordance with standard mortality and disability tables for disabled lives, with interest rates in the case of each reserve as required by the laws of Washington, and/or the rules and regulations of the Insurance Commissioner of that State. Petitioner deducted the statutory percentage of the mean of said reserve funds held by it at the beginning and end of the taxable years 1929 to 1932, inclusive, as provided in Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932 (R. 29).

The Regulations [2] from 1921 until 1935 authorized a deduction of the statutory percentage of the mean of the Disability Reserve, Active Lives and the Disability Reserve, Disabled Lives. Furthermore, Form 1120-L (corporate life insurance income tax return prepared by the Commissioner)

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[2] This paragraph was not covered by the findings, but the regulations were brought to the attention of the court below in the briefs and in the oral argument, and the court referred to them in its opinion.

contained lines for said deductions. On December 18, 1935, T. D. 4615 amended the regulations applicable to the Revenue Act of 1932 and prior Revenue Acts by omitting therefrom the authorization for, but not expressly denying said deductions. The original Regulations applicable to the Revenue Acts of 1921, 1924, 1926, 1928 and 1932, inclusive, contain a specific authorization for a deduction with respect to disability reserves *not required by law* in the case of life insurance companies issuing policies covering life, health and accident insurance combined in one policy issued on the weekly premium payment plan. These Regulations as amended by T. D. 4615, and also Art. 203 (a) (2)-1, Reg. 86 (1934 Act), Art. 203 (a) (2)-1, Reg. 94 (1936 Act) and Art. 203 (a) (2)-1, Reg. 101 (1938 Act) contain this identical provision with respect to disability reserves not required by law in the case of such policies. (See Appendix, p. 32.)

The Commissioner allowed the deduction for petitioner's Disability Reserve, Active Lives for 1929 to 1932, inclusive. He allowed the deduction for petitioner's Disability Reserve, Disabled Lives for 1929 and 1930, but disallowed it for 1931 and 1932. No formal counter claim was filed, but respondent contended in the Court of Claims that the revised Regulations were applicable, and that petitioner was not entitled to any deductions for its Disability Reserve, Active Lives or its Disability Reserve, Disabled Lives for any of said years (R. 47).

The Court of Claims held that the statute permitted a deduction only with respect to life insurance reserves; that it did not comprehend disability reserves such as petitioner's Disability Reserve, Active Lives or Disability Reserve, Disabled Lives; and that the revised Regulations were applicable (R. 51-52).

## Questions Presented.

1. Whether a portion of total salaries paid by petitioner to its officers and cashiers for part-time services rendered

in the investment branch of its business and charged as investment expenses may be deducted by petitioner as "investment expenses" under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932.

2. Whether petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives are "reserve funds" within the meaning of Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932.

## Reasons for Granting the Writ.

### Relative to Investment Expenses.

1. The Court of Claims has rendered a decision in direct conflict with its own previous decision and also in direct conflict with decisions of the Board of Tax Appeals on the identical question.

In *Sun Life Ins. Co.* v. *U. S.* (1935), 81 Ct. Cls. 892, the Court of Claims decided the identical question in favor of the taxpayer, which it decided in favor of the Government in the instant case. The Government did not petition for certiorari in the *Sun Life* case.

Previously, the Board of Tax Appeals in *Volunteer State Life Ins. Co.* v. *Com.* (1933), 27 B. T. A. 1149, had decided the question against the Government, and the Court of Claims in the *Sun Life* case expressly approved the Board's decision. Petition for review was filed by the Commissioner in the Circuit Court of Appeals for the Sixth Circuit. That court, pursuant to stipulation of the parties, reversed and remanded the cause to the Board for such orders as might be stipulated or jointly moved by the parties (35 B. T. A. 491, 493). Later the Board in *Volunteer State Life Ins. Co.* v. *Com.* (1937), 35 B. T. A. 491, followed its former decision. Petition for review by the Commissioner in the latter case is now pending in the United States Circuit Court of Appeals for the Sixth Circuit. One of the questions involved

in the latter case is *res judicata* on account of the former decision.

2. The Court of Claims has decided an important question of Federal law which has not been but should be settled by this Honorable Court.

It is admitted that the entire salary of an officer or employee would be deductible as investment expenses, if he were to devote his entire time to the investment department. The question of whether a portion of total salaries paid to officers and employees for part-time services rendered by them in the investment department and charged on the books as investment expenses may be deducted as investment expenses under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932 and corresponding provisions of other Acts is an important one to life insurance companies and to the Government. It has not been but should be settled by this Honorable Court, particularly when the Court below has decided the identical question both ways, and the Board of Tax Appeals has twice decided it contrary to the latest decision of the Court below.

RELATIVE TO RESERVE FUNDS.

1. The Court of Claims has decided an important question of Federal law in conflict with *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110.

In that case this Honorable Court held that where the Regulations from 1920 to 1934 had provided that gain accruing to a corporation on the purchase and resale of its own shares was not taxable income, the Commissioner could not change the Regulations in 1934 to provide that such gain was taxable income, and then apply the revised Regulations retroactively to the year 1929.

In the instant case, the Regulations from 1921 until 1935 authorized a deduction of the statutory percentage of the

mean of Disability Reserve, Active Lives and Disability Reserve, Disabled Lives; and the life insurance income tax return, Form 1120-L, prepared by the Commissioner contained lines for such deductions. On December 18, 1935, T. D. 4615 amended the Regulations applicable to the Revenue Act of 1932 and prior Revenue Acts by omitting therefrom the authorization for, but not expressly denying said deductions.

The Commissioner allowed petitioner the deduction for its Disability Reserve, Active Lives for 1929 to 1932, inclusive. The Commissioner allowed the deduction for petitioner's Disability Reserve, Disabled Lives for 1929 to 1930, but disallowed it for 1931 and 1932. In the Court of Claims, respondent contended that petitioner was not entitled to any deductions for its Disability Reserve, Active Lives or its Disability Reserve, Disabled Lives, for any of said years, and the Court of Claims held for the respondent (R. 18-20, 23, 59-60).

2. The Court of Claims has decided an important question of Federal law which has not been but should be settled by this Honorable Court.

The Court of Claims held that the term "reserve funds" in Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932 includes only technical life insurance reserves, and that Disability Reserves, Active Lives and Disability Reserves, Disabled Lives are excluded (R. 57). This section, however, authorizes a deduction with respect to

> "the reserve funds required by law and held at the beginning and end of the taxable year * * *"

without any restriction that the deduction shall apply only to the "reserve funds" held for life insurance alone, as the Court of Claims held (R. 57, 59-60).

Petitioner respectfully submits that this Court in *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686, and *Helvering* v. *Illinois Life Ins. Co.*, 299 U. S. 88, relied upon by the Court of Claims as establishing the proposition that only life insurance reserves are comprehended by Sec. 203 (a) (2), did not consider the question at all. These cases involved the question of whether coupon reserves and survivorship fund reserves, respectively, were reserve funds within the meaning of Sec. 203 (a) (2). This Honorable Court held that they were not essentially insurance reserves, which alone were intended by the Statute. It is not disputed that petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives are insurance reserves required by law and held for disability insurance, and the Court of Claims so found (R. 27, 29).

The Board of Tax Appeals held that the term "reserve funds" comprehends Disability Reserves, Active Lives and Disabled Lives in *Equitable Life Assurance Society* v. *Com.* (1935), 33 B. T. A. 708; *Monarch Life Ins. Co.* v. *Com.* (1938), 38 B. T. A. 716, petition for review pending in C. C. A. First; *Pan-American Life Ins. Co.* v. *Com.* (1938), 38 B. T. A. 1430, petition for review pending in C. C. A. Fifth; and *Oregon Mutual Life Ins. Co.* v. *Com.*, Docket Nos. 85,182, 88,299, memorandum opinion filed January 4, 1939, petition for review pending in C. C. A. Ninth.

This question is of importance to all life insurance companies which write policies of combined life, health and accident insurance and which are subject to the income tax imposed by Sec. 201 of the Revenue Acts of 1928 and 1932 and corresponding sections of other Acts.

**Prayer.**

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of

Claims, commanding that court to certify and to send to this Honorable Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 43549, *New World Life Insurance Company, a Corporation* v. *The United States;* and that the said judgment of the United States Court of Claims may be reversed by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

NEW WORLD LIFE INSURANCE COMPANY,
By WALTER E. BARTON,
*Investment Building,*
*Washington, D. C.,*
*Counsel for Petitioner.*

## BRIEF IN SUPPORT OF PETITION.

### Opinion Below.

The opinion of the court below (R. 32) is reported in 26 Fed. Supp. 444.

### Jurisdiction.

The jurisdiction of this Court is set forth in the petition on page 1 above.

### Questions Presented.

The questions presented are set forth in the petition on pages 8 and 9 above.

### Statutes and Regulations Involved.

The statutes and regulations involved are set forth in an Appendix attached to the brief.

### Statement of the Case.

A statement of the case is made in the petition, beginning on page 2.

### Specification of Errors to be Urged.

1. The Court of Claims erred in holding that the portion of total salaries paid by petitioner to its officers and cashiers for part-time services rendered in the investment branch of its business and charged as investment expenses during 1929 to 1932, inclusive, were not deductible as investment expenses for said years under Section 203 (a) (5) of the Revenue Acts of 1928 and 1932.

2. The court below erred in holding that the charging to investment expenses of a portion of total salaries paid by

petitioner to its officers and cashiers for part-time services rendered in the investment branch of its business during 1929 to 1932, inclusive, constituted an assignment of general expenses to investment expenses during said years within the meaning of Section 203 (a) (5) of the Revenue Acts of 1928 and 1932.

3. The court below erred in holding that petitioner was not entitled to a deduction of the statutory percentage of the mean of reserve funds required by law and held by petitioner at the beginning and end of its taxable years 1929 to 1932, inclusive, for Total and Permanent Disability Benefits, Active Lives, within the meaning of Section 203 (a) (2) of the Revenue Acts of 1928 and 1932.

4. The court below erred in holding that petitioner was not entitled to a deduction of the statutory percentage of the mean of reserve funds required by law and held by petitioner at the beginning and end of its taxable years 1929 to 1932, inclusive, for Total and Permanent Disability Benefits, Disabled Lives, within the meaning of Section 203 (a) (2) of the Revenue Acts of 1928 and 1932.

## ARGUMENT.

### Relative to Investment Expenses.

### I.

### The Court of Claims Has Decided the Question Both Ways, and the Board of Tax Appeals Has Decided It Contrary to the Latest Decision of the Court of Claims.

The Court of Claims in *Sun Life Ins. Co.* v. *U. S.* (1935), 81 Ct. Cls. 892, held that where a certain percentage of total salaries was paid to officers for services rendered in the investment department, the amount paid was deductible as investment expenses under Sec. 245 (a) (5) of the Revenue

Act of 1924. That section is the same as Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932, which reads:

> "Investment expenses paid during the taxable year: *Provided,* That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year."

The proviso regarding the assignment of general expenses to investment expenses was held by the Court of Claims in the *Sun Life* case to apply only

> "when an attempt was made to improperly increase the amount of investment expenses. The purpose of the proviso so far as we can determine from the language used and its connection with the remainder of the section is to prevent 'padding' of the investment expenses by requiring the insurance companies to make a definite showing of how much has been expended for investment purposes and how much upon the insurance business."

The Government did not file a petition for a writ of certiorari in the *Sun Life* case.

Notwithstanding its decision in the *Sun Life* case, the Court of Claims in the instant case decided the question in favor of the Government. The latest decision of the Court of Claims is contrary to the decision of the Board of Tax Appeals in *Volunteer State Life Ins. Co.* (1933), 27 B. T. A. 1149, in which the Board held that where general officers were paid specific sums for services rendered in the investment department and additional amounts for services rendered in the insurance department, the amounts paid for services performed in the investment department were de-

ductible as investment expenses. This decision of the Board was expressly approved by the Court of Claims in the *Sun Life* case. Later, in *Volunteer State Life Ins. Co.* (1937), 35 B. T. A. 491, the Board adhered to its former decision.

The Commissioner filed petition for review in the first Board case, 27 B. T. A. 1149, in the Circuit Court of Appeals for the Sixth Circuit; and that court, pursuant to stipulation of the parties, reversed and remanded the cause to the Board for such orders as might be stipulated or jointly moved by the parties (35 B. T. A. 491, 493). Later the parties filed a stipulation in the Board that the Board might find an overpayment, based in part upon the allowance of a deduction for investment expenses, representing a portion of salaries paid to officers for services rendered in the investment department. Pursuant to this stipulation, the Board entered such an order (35 B. T. A. 491, 494). Petition for review was also filed by the Commissioner in the last Board case, 35 B. T. A. 491, which is now pending in the Circuit Court of Appeals for the Sixth Circuit. One of the questions involved in the later case is whether the deductibility of a portion of officers' salaries as investment expenses is *res judicata* on account of the former decision.

In view of the uncertainty as to what the law is, as evidenced by the two contradictory decisions of the Court of Claims and the decisions of the Board of Tax Appeals, and also in view of the importance of the question, petitioner respectfully submits that this Court should grant certiorari and settle the question of whether portions of salaries paid to officers and employees for part-time services actually rendered in the investment department and charged to investment expenses are deductible as investment expenses under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932.

**Relative to Reserve Funds.**

I.

The Decision of the Court of Claims Is in Direct Conflict with *Helvering* v. *R. J. Reynolds Tobacco Company*, 306 U. S. 110.

In that case, this Honorable Court held that the Commissioner could not amend his Regulations in 1934 and apply them retroactively so as to require a taxpayer to include in taxable gross income for 1929 gains realized in buying and selling its own stock and bonds, where the Regulations in force from 1920 to 1934, inclusive, provided that such gains were not required to be included in taxable gross income, and the statute was reenacted without change over the period covered by the Regulations. We quote from this Court's opinion as follows:

> "The administrative construction embodied in the regulation has, since at least 1920, been uniform with respect to each of the revenue acts from that of 1913 to that of 1932, as evidenced by Treasury rulings and regulations, and decisions of the Board of Tax Appeals. In the meantime successive revenue acts have reenacted, without alteration, the definition of gross income as it stood in the Acts of 1913, 1916, and 1918. Under the established rule Congress must be taken to have approved the administrative construction and thereby to have given it the force of law.
>
> • • • • • • •
>
> "We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.
>
> • • • • • • •
>
> "Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force

of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

A similar situation obtains in the instant case. From 1921, when the present basis of taxing life insurance companies was adopted, until 1935, the Commissioner's regulations have authorized a deduction for Disability Reserves, Active Lives and Disability Reserves, Disabled Lives. (Art. 681, Reg. 62 (1921 Act); Art. 681, Reg. 65 (1924 Act); Art. 681, Reg. 69 (1926 Act); Art. 971, Reg. 74 (1928 Act); Art. 971, Reg. 77 (1932 Act).) (See Appendix, p. 32.)

On February 11, 1935, the Commissioner promulgated Art. 203 (a) (2)-1 of Reg. 86, which is applicable to the Revenue Act of 1934, *and for the first time omitted the following provision*, which had been included in the five prior regulations, beginning in 1921:

> "Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual statement for life insurance companies."

Lines 8 and 9 of the Annual Statement [3] for life insurance companies for the taxable years involved were as follows:

> "8. Extra reserve [4] for total and permanent disability benefits (less $—— reinsurance) $——; and for additional accidental death benefits (less $—— reinsurance) $——, included in life policies ..... $——
> "9. Present value of amounts incurred but not yet due for total and permanent disability benefits [5] (less $—— reinsurance) $——"

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[3] This Court will take judicial notice of the Annual Statement and the Federal Income Tax Return, as they are public documents required to be filed with State Insurance Commissioners and the Commissioner of Internal Revenue, respectively.

[4] This line pertains to Disability Reserve, Active Lives.

[5] This line pertains to Disability Reserve, Disabled Lives.

Furthermore, the life insurance company income tax return, Form 1120-L[3], prepared by the Commissioner to give effect to his Regulations for the taxable years 1921 to 1933, inclusive, contained the following lines for deductions:

"2. Reserve for disability[4] and accidental death benefits ..... $———

"4. Reserve for incurred disability benefits[5] $———"

Finally, on December 18, 1935, T. D. 4615 (C. B. XIV-2, pp. 310, 312) amended Art. 681 of Reg. 62, 65 and 69 and Art. 971 of Reg. 74 and 77, applicable to the revenue Acts of 1921, 1924, 1926, 1928 and 1932, respectively, by omitting the same language that was omitted from Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), and subsequently omitted from Art. 203 (a) (2)-1 of Reg. 94 (1936 Act) and Art. 203 (a) (2)-1 of Reg. 101 (1938 Act); viz:

> "Generally speaking, the following will be considered reserves as contemplated by the law: Items 7-11 of the liability page of the annual statement for life insurance companies."

The Commissioner applied the old Regulations to petitioner's taxable years 1929 to 1932, inclusive, with respect to petitioner's Disability Reserve, Active Lives, and allowed the deductions. He applied the old Regulations to 1929 and 1930 with respect to petitioner's Disability Reserve, Disabled Lives, and allowed the deductions, but he applied the revised Regulatons to petitioner's Disability Reserve, Disabled Lives for 1931 and 1932, and disallowed the deductions. Although not filing any formal counter claim, the respondent contended in the Court of Claims that the revised Regulations were applicable to all years with respect to petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives, and that the Commissioner erred in allowing any deductions on account of petitioner's

said reserve funds. The Court of Claims agreed with respondent and held that the amended Regulations applied, and that petitioner was not entitled to any deductions with respect to its Disability Reserve, Active Lives or its Disability Reserve, Disabled Lives (R. 18-21, 23, 59-60).

In Sec. 245 (a) (2) of the Revenue Acts of 1921, 1924, 1926, and in Sec. 203 (a) (2) of the Revenue Act of 1928, Congress provided for a deduction of:

> "An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only."

In 1928, this Court held in *National Life Ins. Co.* v. *U. S.*, 277 U. S. 508, that the limitation on account of exempt interest was unconstitutional. Accordingly, Sec. 203 (a) (2) of the Revenue Acts of 1932, 1934, 1936 and 1938 does not contain this limitation. Furthermore, in these Acts the percentage deduction is reduced to 3¾% in the case of life insurance companies using an interest assumption rate less than 4%. Aside from these immaterial differences, every Revenue Act from 1921 to date has contained the same provision for a deduction of 4% of the mean of reserve funds required by law and held at the beginning and end of the taxable year.

By reenacting without change throughout the entire history of the legislation the same language regarding the deduction for reserve funds, Congress must be presumed to

have given legislative approval to existing Regulations. Petitioner accordingly submits that the decision of the Court of Claims holding that the revised Regulations promulgated in 1935 were applicable to petitioner's taxable years 1929 to 1932, inclusive, is directly in conflict with the decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co., supra.*

## II.

### The Decision of the Court of Claims Unduly Restricts the Decisions of This Court in *Helvering* v. *Inter-Mountain Life Insurance Company,* 294 U. S. 686, and *Helvering* v. *Illinois Life Insurance Company,* 299 U. S. 88.

In the *Inter-Mountain Life* case, this Court decided that assets held by a life insurance company against matured and unpaid coupons attached to life insurance coupon policies under which the company promised to pay the owners of the policies at their respective maturities the amounts specified, were not reserve funds within the meaning of the Act; but in reality, the equivalent of cash that the policyholders could use for the purchase of additional insurance, or otherwise obtain insurance protection. It was held that

> "in life insurance, the reserve means the amount accumulated by the company out of premium payments which is attributable to and represents the value of the life insurance elements of the policy contracts."

The above language of the court is to be read in the light of the issue presented; and concededly, there was no issue regarding the right of a life insurance company to take a deduction with respect to Disability Reserves, Active Lives or Disabled Lives. (*Webster* v. *Fall,* 266 U. S. 507,

511; *U. S.* v. *Mitchell,* 271 U. S. 9, 14; *Sinclair* v. *U. S.,* 279 U. S. 749, 767.)

That the court's opinion in the *Inter-Mountain Life* case is not to be construed as holding that a life insurance company may take a deduction only with respect to life insurance reserves is clear from the opinion of this Court in *Helvering* v. *Illinois Life Ins. Co.,* 299 U. S. 88, in which it was held that survivorship fund reserves were not reserve funds within the meaning of the Revenue Act. There the court specifically referred to its decision in the *Inter-Mountain Life* case and said:

> "That decision rests upon the ground that the reserves in respect of the coupon liability were not essentially *insurance reserves* which alone constitute the base on which deduction is computed." (Italics ours.)

The Court of Claims found that petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives were insurance reserve funds maintained out of premiums, as required by the law of the State of Washington, to meet its obligations under the disability provisions of its contracts of combined life, health and accident insurance. (R. 29, 30.) Nevertheless, the Court of Claims read into Section 203 (a) (2) the word "life," which is not there. (R. 51, 59.) This, notwithstanding the same section specifically provides for a deduction of reserve funds *not required by law* in the case of life insurance companies issuing policies covering life, health and accident insurance combined in one policy issued on the weekly premium plan. The term "reserve funds not required by law," in the last sentence of Sec. 203 (a) (2), clearly refers to reserve funds for health and accident insurance, viz., disability insurance, inasmuch as life reserves *were required by law* in all States when the Revenue Act of 1921 was enacted, that Act being

the first Act in which the present scheme for the taxation of life insurance companies was adopted.[6] The Commis-

[6] A careful examination of the statutes of the various States discloses that in 1921 life insurance companies were required to hold reserve funds for all life insurance represented by their outstanding policies. That the provision allowing a deduction for "reserve funds not required by law" was intended to apply only to reserve funds for accident and health insurance, *i. e.*, disability insurance, is shown by the following official minutes relative to Sec. 245 (a) (2) of the Revenue Act of 1921 (which corresponds to Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932):

"Dr. Adams. Let me explain that. There are developing at the present time, and have been for a few years past, companies which insure combined accident, health, and life insurance policies. There is no proper actuarial basis for it. Consequently, there are no laws stipulating what reserve shall be held against it. It is particularly necessary that there should be large reserves for it. It is a particularly dangerous form of policy for the companies and specially high reserves have to be held. Now, in all insurance in the past we have exempted only the reserves required by law. But here is a small class of companies which under a moral and real compulsion retain specially high reserves, but the law does not require any. Consequently, they come in and say, 'We want a special reserve for this purpose; we are sure that you will acquiesce.' They say this to the department and to the Congress:

'In the necessity for these reserves we are perfectly willing to let you fix them, only we want some deduction.' That is the essence of their statement."

"Senator Curtis. It authorizes the Secretary to fix the reserve if it is not fixed by law."

• • • • • • •

"Senator Dillingham. I understand Dr. Adams says there are laws in every State of the Union regulating reserves and straight insurance companies."

"Dr. Adams. There are laws in every State of the Union fixing them absolutely."

"Senator Dillingham. But now with the new form of policy covering accidents and health the States have not adopted statutes saying what the reserve shall be in those cases."

"Dr. Adams. They have not because they do not know what they will be."

(Confidential Print for Use of Members of the Senate relative to hearings before the Committee on Finance, United States Senate, 67th Cong., 1st Sess. on H. R. 8245, an act to reduce and equalize taxation, to amend and simplify the Revenue Act of 1918, and for other purposes, September 1—October 1, 1921.)

sioner himself has recognized that this is true, because the following provision relative to reserve funds not required by law has been incorporated into all Regulations, original and amended, from 1921 to the present time:

> "In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering *disability benefits* of the kind contained in policies issued by this particular class of companies." (Italics ours.) (Appendix, p. 32, *et seq.*)

Petitioner respectfully submits that the term "reserve funds" has the same meaning in the first sentence of Sec. 203 (a) (2) that it has in the second sentence of said section; otherwise, it would be necessary to impute to Congress an intent to deny a deduction for disability reserve funds *required by law* with respect to contracts of combined life, health and accident insurance, and to allow a deduction for disability reserve funds *not required by law* with respect to such policies issued on the weekly premium plan—a construction not only not required by Sec. 203 (a) (2), but contrary to its express language.

## III.

### The Decision of the Court of Claims Fails to Give Effect to the General Scheme Which Congress Provided for the Taxation of Insurance Companies.

The Revenue Acts of 1928 and 1932, as well as prior Acts beginning in 1921, and subsequent Acts up to the present time, have provided for the taxation of insurance companies under three different classifications. Under the Revenue Acts of 1928 and 1932 and corresponding sections

of prior and subsequent Acts, life insurance companies are taxed under Sections 201, 202 and 203; insurance companies other than life or mutual under Section 204; and mutual insurance companies other than life under Sections 207 and 208. (See Appendix, p. 30.)

Life insurance companies include in gross income only income from investments, such as dividends, interest and rents, excluding therefrom premium income. (Sec. 202 (a).) They are not allowed any deduction for amounts actually paid to policyholders in satisfaction of claims when they mature; but life insurance companies are allowed a deduction of an amount equal to 3¾% or 4% of the mean of reserve funds which are set up for the purpose of enabling them to pay claims under their policies when they mature. (Sec. 203 (a) (2).) Life insurance companies, therefore, are not taxed on premium receipts or on that portion of investment income added to reserve funds to pay policyholders' claims.

Insurance companies other than life or mutual include in gross income investment income and premiums earned. (Sec. 204 (b) (1)-(5).) They are allowed deductions for "losses incurred," i. e., the amounts which they actually pay to policyholders. (Sec. 204 (b) (6).) Insurance companies other than life or mutual, therefore, are not taxed on that portion of premium receipts or investment income used to pay policyholders' claims.

Mutual insurance companies other than life include in gross income investment income and premium income. (Sec. 208 (a).) They are permitted to deduct "the net addition required by law to be made within the taxable year to reserve funds." (Sec. 208 (c) (1).) These companies are not allowed any deduction for amounts actually paid to policyholders, but they are given a deduction of that portion of premium receipts and investment income

which is set aside to provide for the payment of policy claims when they mature.

Thus it will be seen that under each of the three methods of taxing insurance companies, Congress has not taxed any class of insurance company on that portion of premium receipts and investment income which is paid over to the policyholders in fulfillment of its insurance obligations. The method of accomplishing this varies; but the result is the same. For instance, life insurance companies and mutual insurance companies other than life get their exclusions or deductions from gross income at the time when the amounts are set aside in reserve funds; whereas, insurance companies other than life or mutual get their deductions in the form of losses incurred during the taxable year on insurance contracts, these losses consisting of payments made out of premium receipts and investment income.

In attempting to understand what Congress intended by "reserve funds" in Section 203 (a) (2), the general scheme of taxing insurance companies should be kept in mind. The decision of the Court of Claims in the instant case is out of harmony with this plan; because the Court has denied the petitioner a deduction for that part of its investment income credited to its reserve funds and held to satisfy its contingent and unaccrued obligations under the disability provisions of its contracts of combined life, health and accident insurance. If the petitioner were taxable as an insurance company other than life or mutual, it would be allowed a corresponding deduction for "losses incurred," and if it were taxable as a mutual insurance company other than life, it would be entitled to a corresponding deduction as "net addition * * * to reserve funds." It should not be presumed that Congress intended to deny a life insurance company a deduction which all other insurance companies receive. Clearly, such an inequitable result should not be presumed in the absence of express language.

Petitioner respectfully submits that the construction for which it contends is the only reasonable one; because Congress has not limited or qualified the meaning of the term "reserve funds" in Section 203 (a) (2). Consequently, the words should be given their unqualified meaning, which is the only one that is in harmony with the general scheme of taxation which Congress has provided for all insurance companies from 1921 to the present day.

## IV.

### The Decision of the Court of Claims is in Conflict with Decisions of the United States Board of Tax Appeals.

The Board of Tax Appeals in well-reasoned opinions in *Equitable Life Assurance Society* v. *Com.* (1935), 33 B. T. A. 708; *Monarch Life Ins. Co.* v. *Com.* (1938), 38 B. T. A. 716 (petition for review pending in C. C. A. First); *Pan-American Life Ins. Co.* v. *Com.* (1938), 38 B. T. A. 1430 (petition for review pending in C. C. A. Fifth); and *Oregon Mutual Life Ins. Co.* v. *Com.* (1939), memorandum opinion filed January 4, 1939, Docket Nos. 85,182, 88,299 (petition for review pending in C. C. A. Ninth), held that disability reserves, such as petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives, are reserve funds within the meaning of Sec. 203 (a) (2) and corresponding sections of the Revenue Acts.

Inasmuch as a large number of life insurance companies write disability insurance in contracts of combined life, health and accident insurance, the question is one which will continue to be presented to the various courts and the Board of Tax Appeals until this Court has settled the question. Final adjudication of the question, therefore, is of importance to most of the life insurance companies in the United States, as well as to the Government.

## Conclusion.

It is respectfully submitted that the decision of the Court of Claims is erroneous, and that the foregoing petition for a writ of certiorari should be granted.

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*Counsel for Petitioner.*

# APPENDIX.

## Statutes.

REVENUE ACTS OF 1928 AND 1932.

(The sections are the same in both Acts, except Sec. 203 (a) (1) and (2).)

SEC. 201. Tax on life insurance companies.

(a) Definition.—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

SEC. 202. Gross income of life insurance companies.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

SEC. 203. Net income of life insurance companies.

(a) General rule.—In the case of a life insurance company the term "net income" means the gross income less—

(1)[7] Tax-free interest.—The amount of interest received during the taxable year which under section 22 (b) is exempt from taxation under this title;

(1)[8] Tax-free interest.—The amount of interest received during the taxable year which under section 22 (b) is exempt from the taxes imposed by this title;

---

[7] The following is Sec. 203 (a) (1) of the Revenue Act of 1928. Sec. 203 (a) (1) of the Revenue Act of 1932 follows.

[8] The following is Sec. 203 (a) (1) of the Revenue Act of 1932. Sec. 203 (a) (1) of the Revenue Act of 1928 is immediately above.

SEC. 203 (a) (2).[9] Reserve funds.—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

SEC. 203 (a) (2).[10] Reserve funds.—An amount equal to 4 per centum of the mean of the reserve fund required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

SEC. 203 (a) (5). Investment expenses.—Investment expenses paid during the taxable year: *Provided,* That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

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[9] The following is Sec. 203 (a) (2) of the Revenue Act of 1928. Sec. 203 (a) (2) of the Revenue Act of 1932 follows.

[10] The following is Sec. 203 (a) (2) of the Revenue Act of 1932. Sec. 203 (a) (2) of the Revenue Act of 1928 is immediately above.

**Regulations.**

Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act) prior to amendment, as hereinafter referred to, were the same and read as follows:

"Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

"(1) Interest which is exempted in the case of other taxpayers by section 22 (b) (4) and articles 84-87;[11] and

"(2) Four per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per cent shall be substituted for 4 per cent. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

"In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is 3¾ per cent of the mean of such reserve

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[11] 88 in Art. 971 of Reg. 74.

funds held at the beginning and end of the taxable year. Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual Statement. Generally speaking, the following will be considered reserves as contemplated by the law: *Items 7-11 of the liability page of the annual statement for life insurance companies, and items 16-19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business.* If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered." (Italics ours.)

In all material respects, Art. 681 of Reg. 62 (1921 Act), Art. 681 of Reg. 65 (1924 Act) and Art. 681 of Reg. 69 (1926 Act) prior to amendment, as hereinafter referred to, were the same as Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act), *supra.*

On February 11, 1935, Art. 203 (a) (2)-1 of Reg. 86 (1934 Act) was promulgated, which reads as follows:

"In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future un-

accrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

"In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

"In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering

disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is 3¾ per cent of the mean of such reserve funds held at the beginning and end of the taxable year."

Later the Commissioner promulgated Art. 203 (a) (2)-1 of Reg. 94 (1936 Act) and Art. 203 (a) (2)-1 of Reg. 101 (1938 Act), which articles were exactly the same as Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), *supra*. It will be observed that Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), 94 (1936 Act) and 101 (1938 Act) omitted the language which we italicized of Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act), and which was also contained in Art. 681 of Reg. 62 (1921 Act), Art. 681 of Reg. 65 (1924 Act) and Art. 681 of Reg. 69 (1926 Act), *supra*. On December 18, 1935 the last-mentioned Regulations, namely, Art. 681 of Reg. 62 (1921 Act), 65 (1924 Act) and 69 (1926 Act), and Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act) were amended by T. D. 4615 to read in all material respects the same as Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), 94 (1936 Act) and 101 (1938 Act), omitting therefrom the italicized language referred to which was contained in said Regulations prior to amendment by T. D. 4615.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 2

NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

**On Petition for a Writ of Certiorari to the United States Court of Claims.**

## PETITIONER'S REPLY BRIEF.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939.

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No. 417.

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NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

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**On Petition for a Writ of Certiorari to the United States Court of Claims.**

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## PETITIONER'S REPLY BRIEF.

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*To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:*

### I.

### INVESTMENT EXPENSES.

Respondent states the question to be whether a life insurance company may for Federal income tax purposes allocate to and deduct as investment expenses, without limitation, a portion of the salaries paid to its officers for services performed generally in all departments of its business. (Resp. Brief 2.)

Petitioner respectfully submits that the question is whether a portion of total salaries paid by a life insurance company to its officers and cashiers for part-time services rendered by them in the investment branch of its business and charged as investment expenses on its books may be deducted as investment expenses. (Pet. 8; R. 24, 25.)

No question of assignment of general expenses to investment expenses is involved.

Petitioner does not claim a deduction *without limitation* of a portion of salaries paid *for services performed generally*. The deduction claimed is for a portion of total salaries paid for part-time services *actually performed in the investment department* and charged on the books as investment expenses. Petitioner contends that that portion of total salaries paid for part-time services actually performed in the investment department are actual investment expenses and not an assignment of general expenses to investment expenses. (R. 24, 25.)

Respondent's statement that the decision of the Court below is not in conflict with any decision of any Federal Court of Appeals is true (Resp. Br. 7); but the decision of the Court below is directly in conflict with its own decision in *Sun Life Ins. Co.* v. *U. S.*, 81 Ct. Cls. 892, on the identical issue.

## II.

## RESERVE FUNDS.

The question as stated by the respondent is broad enough to cover separate policies of health and accident insurance. (Resp. Brief 2.) The question pertains solely to reserve funds for health and accident insurance, issued in combined* policies of life, health and accident insurance. (R. 18.)

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*A life insurance company is defined in Sec. 201 (a) of the Revenue Act of 1928 as

"an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health and accident insurance) the reserve funds of which held for the fulfillment of such contracts comprise more than 50 percentum of its total reserve funds."

Respondent argues that the decision of the Court below follows the decisions of this Court in *Helvering* v. *Illinois Life Ins. Co.*, 299 U. S. 88, and *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686, notwithstanding the fact that this Court in the former case was considering survivorship fund reserves, and in the latter, coupon reserves,—no question of disability fund reserves being involved in either case. Although this Court in the *Inter-Mountain Life* case used the broad language that

> "in life insurance, the reserve means the amount accumulated by the company out of premium payments which is attributable to and represents the value of the life insurance elements of the policy contracts";

in the *Illinois Life* case this Court specifically stated that its decision in the *Inter-Mountain Life* case

> "rests upon the ground that the reserves in respect of the coupon liability were not essentially *insurance reserves* which alone constitute the base on which deduction is computed." (Italics ours.)

The Court below did not hold, nor does the Government contend in its brief in opposition, that the disability reserves involved in this suit are not "insurance reserves." Clearly, the decision of the Court below cannot be deemed to be in accordance with the decisions of this Court in the two foregoing cases, as respondent argues, when the questions involved in those cases were entirely different from the question involved herein.

Respondent argues that *Helvering* v. *Reynolds Tobacco Company*, 306 U. S. 110, is not controlling on the question of whether the Commissioner could in 1935 amend his Regulations, which had been in force since 1921, and apply them retroactively to 1929. In that case this Court held that Section 22 (a) of the Revenue Act of 1928 defining gross income was "so general in its terms as to render an interpretative regulation appropriate"; and that in such a sit-

uation the Commissioner could not amend his Regulations and apply them retroactively.

Section 203 (a) (2) of the Revenue Act of 1928 is equally general in its nature as Section 22 (a), if not, in fact, more general, and likewise, renders an interpretative regulation appropriate, inasmuch as it authorizes a deduction of

> "an amount equal to 4 per centum of the mean of reserve funds required by law and held at the beginning and end of the taxable year * * *"

without any statutory definition or qualification whatsoever of the term "reserve funds."

Other cases cited by the respondent are not in point. They do not involve the question of whether the Commissioner can amend his regulations and apply them retroactively, where the Statute is so general as to render an interpretative regulation appropriate, as here.

*Manhattan Company* v. *Com.*, 297 U. S. 129, 134, 135, holds that the Commissioner cannot amend an original regulation which is "contrary to the intent of the statute," and which is "both inconsistent with the statute and unreasonable," inasmuch as such original regulation is a "mere nullity"; and there is no question, therefore, of retroactivity.

*Morrissey* v. *Com.*, 296 U. S. 344, 355, holds that the Commissioner could amend his regulations to accord with the decision of this Court in *Hect* v. *Malley*, 265 U. S. 144.

*Koshland* v. *Helvering*, 298 U. S. 441, 446, 447, holds that where a statute is unambiguous and its directions specific, there is no power in the first instance to amend it by regulation.

*Bittle* v. *Com.*, 302 U. S. 573, 582, holds that a regulation construing a *foreign law* does not have the force of law by virtue of subsequent reenactments by the Congress.

## III.

## BOTH ISSUES ARE IMPORTANT QUESTIONS OF FEDERAL LAW WHICH HAVE NOT BEEN BUT SHOULD BE SETTLED BY THIS COURT.

The question involving investment expenses is of importance to every life insurance company in the United States; and the question involving disability reserve funds is of equal importance, as "Best's Life Insurance Reports" for the year ended 1938 discloses that there are at least two hundred and ninety life insurance companies writing disability insurance. Furthermore, a large number of these companies are mutual companies in which the many millions of policyholders are the ultimate parties in interest, inasmuch as the cost of their insurance will be affected by the final decision in this case.

Counsel has been advised that a large number of cases involving the disability reserve fund question are pending in the Treasury Department awaiting final adjudication of this question. Furthermore, the following cases are pending in the Courts and in the Board of Tax Appeals in which the disability reserve fund issue is involved:

1. In the United States Circuit Courts of Appeals:

*Monarch Life Insurance Company* (First Circuit), Docket Nos. 3470, 3475, 38 B. T. A. 95, which is set down for argument in January, 1940;

*Pan-American Life Insurance Company* (Fifth Circuit), Docket No. 9175, 38 B. T. A. 188, which probably will be set down for argument not later than February or March, 1940;

*Oregon Mutual Life Insurance Company* (Ninth Circuit), Docket No. 9318, B. T. A. Memo. Opinion, Nos. 85182, 88299, which probably will be set down for argument early during 1940.

2. In the COURT OF CLAIMS:

*Amicable Life Insurance Company*, No. 44588;
*New World Life Insurance Company*, No. 44599.

3. In the FEDERAL DISTRICT COURT OF MASSACHUSETTS:

*Paul Revere Life Insurance Company*, No. 307.

4. In the BOARD OF TAX APPEALS:

*Equitable Life Assurance Society of the United States*, Nos. 89294, 93805;
*Great Southern Life Insurance Company*, No. 95384;
*Federal Life Insurance Company*, No. 99419;
*Massachusetts Mutual Life Insurance Company* No. 98856;
*New World Life Insurance Company*, No. 98355;
*United Life & Accident Insurance Company*, No. 85321;
*United Life & Accident Insurance Company*, No. 93815.

On the question of investment expenses the following cases are pending:

1. In the UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT:

*Volunteer State Life Insurance Company*, No. 35 B. T. A. 491, which was argued on October 10, 1939.

2. In the FEDERAL DISTRICT COURT OF MASSACHUSETTS:

*Boston Mutual Life Insurance Company* v. *White*, Nos. 5332, 5333, 5334.

3. In the COURT OF CLAIMS:

*Amicable Life Insurance Company*, No. 44599;
*New World Life Insurance Company*, No. 44588.

4. In the Board of Tax Appeals:

*New World Life Insurance Company*, No. 98355;
*United Life & Accident Insurance Company*, No. 85321;
*United Life & Accident Insurance Company*, No. 93815.

In view of the large number of cases now pending in the various Courts and the Board of Tax Appeals, it is practically a certainty that both questions presented herein will come before this Court during the coming year. It is respectfully submitted that it would be for the best interest of all life insurance companies and the Government, if this Court would grant certiorari in this case and definitely settle the questions at this time.

## CONCLUSION.

It is respectfully submitted that the petition for a writ of certiorari herein should be granted.

Walter E. Barton,
Investment Building,
Washington, D. C.,
*Counsel for Petitioner.*

FILED SEP 30 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1940.

No. 2.

NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

**Petitioner's Brief in Opposition to Respondent's Motion to Dismiss Writ of Certiorari.**

**Petitioner's Motion for Leave to File Waiver of Statute of Limitations and Consent to Judgment.**

**Waiver of Statute of Limitations and Consent to Judgment.**

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

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OCTOBER TERM, 1940.

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No. 2.

---

NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

---

**On Petition for a Writ of Certiorari to the United States Court of Claims.**

---

## PETITIONER'S BRIEF IN OPPOSITION TO RESPONDENT'S MOTION TO DISMISS WRIT OF CERTIORARI.

The respondent has filed a motion to dismiss the writ of certiorari herein on the ground that the question presented by the writ is now moot, and that the judgment of the Court below would remain unchanged regardless of how this Court might decide the pending issue. (Resp. Motion, 1.)

The petitioner sued in the Court of Claims for a refund of income taxes for the years 1929 to 1932, inclusive, on the ground that petitioner was entitled to a deduction for in-

vestment expenses paid. (R. 3, 6, 9, 13.) The respondent raised the question of petitioner's right to a deduction of four per cent[1] of the mean of Reserves for Total and Permanent Disability Benefits, Active Lives and Disabled Lives, which deduction petitioner had taken in computing the amount of refund due. The respondent asked the Court of Claims to hold that such reserve deduction was not allowable in determining the amount of refund due, but did not ask for any affirmative judgment for income taxes underpaid, on account of the fact that the statute of limitations barred the collection thereof. (R. 17, 47.) The Court of Claims held that said investment expenses were not deductible, and also held that said reserve deduction was not allowable, but did not render affirmative judgment in favor of the respondent due to the statute of limitations. (R. 32, 45, 60.)

The petitioner has another case pending in the Court of Claims, New World Life Insurance Company v. The United States, No. 44580, involving the question of whether petitioner is entitled to deductions of $5,376.94 and $5,417.88 for the years 1933 and 1934, respectively, representing 3¾ per cent of the mean of Reserves for Total and Permanent Disability Benefits, Disabled Lives.

If the writ were to be dismissed in the instant case on the ground that the question presented is moot, and the Court of Claims were to be reversed on that issue in accordance with the usual procedure of this Court in such cases, the petitioner and the respondent in all probability would be compelled to litigate anew in the Court of Claims and in this Court an identical question now presented by the present writ; viz., whether petitioner is entitled to a deduction of 3¾ per cent[2] of the mean of Reserves for Total and Permanent Disability Benefits, Disabled Lives, a procedure expensive to the petitioner and to the Government, as well as an unnecessary burden upon the Court of Claims

[1] 3¼% for 1932.

[2] Or 4%.

and this Court. Furthermore, the question is a recurring one from year to year not only to the petitoner, but also to practically every life insurance company in the United States,[3] inasmuch as there has been no material change in the law in respect of such reserve deductions since 1921.

This unnecessary litigation and expense would be the probable result of this Court's dismissing the writ and reversing the Court of Claims on the reserve fund deduction issue in the instant case, for the result would be that there would be no conflict upon which to base certiorari (Rule 38, par. 5), inasmuch as all other decisions of United States Circuit Courts of Appeals to date, involving the same question, have held that such reserve deduction is allowable to a life insurance company. (*Com.* v. ***Pan American Life Insurance Co.*** (C. C. A. 5) 111 F. (2d) 366, Government's petition for certiorari pending, No. 264; *Com.* v. ***Oregon Mutual Life Insurance Co.*** (C. C. A. 9) 112 F. (2d) 468, Government's motion for 60-day extension of time from September 12, 1940 to file petition for certiorari granted by this Court on August 22, 1940; and ***Monarch Life Insurance Co.*** v. *Com.* (C. C. A. 1) 113 F. (2d) —.) In fact, the respondent recognizes the probability of this Court's denying the Government's petition for certiorari in the *Pan American Life Insurance Company* case in the event of the dismissal of the writ in the instant case. (Resp. Motion, p. 5, fn. 3.) Furthermore, petitioner is informed that the insurance company proposes to file a brief in opposition to the Government's petition for a writ of certiorari in that case, on the ground that there will be no conflict, if this Court should dismiss the writ in the instant case.

Petitioner respectfully submits that the pendency in the Court of Claims of petitioner's suit for a refund of income taxes for the years 1933 and 1934 involving a question presented in the present writ is sufficient ground for this Court

---

[3] Best's Life Reports for 1938 show that there are at least 300 life insurance companies doing business in the United States.

to deny the respondent's motion to dismiss the writ and to proceed to hear the within cause on the merits and to decide the question involved. If, however, petitioner be mistaken in this, petitioner respectfully submits its Motion for Leave to File the Attached Waiver of Statute of Limitations and Consent to Judgment for the year 1931, and if this Court should grant said motion, there would be an unquestioned controversy between the parties, which this Court might hear and decide, and thereby obviate further litigation between them in respect of the identical issue.

The question of petitioner's right to a deduction in respect of said reserve funds was not moot in the Court of Claims, as suggested by respondent in its motion to dismiss the writ (Resp. Motion, p. 3); and did not become moot in any event before this Court denied the petition for a writ of certiorari in respect of the investment expense question. Accordingly petitioner did not consider it appropriate to file a Waiver of the Statute of Limitations and Consent to Judgment in the Court of Claims.

That anyone other than the Government[4] entitled to rely upon the statute of limitations may waive it is well established by the decisions of the State and Federal courts. (*Randon* v. *Foby*, 11 How. 393; *Sanger* v. *Nightingale*, 122 U. S. 176; *Allen* v. *Smith*, 129 U. S. 465; 37 C. J. 721; 17 R. C. L. 881.) Petitioner, therefore, submits that it has the right to file the attached Waiver of the Statute of Limitations and Consent to Judgment at this time.

In the event that this Court should deny petitioner's Motion for Leave to file Waiver of Statute of Limitations and Consent to Judgment and grant respondent's motion to dismiss the writ herein on the ground that the question presented is moot, petitioner respectfully asks the Court to reverse the Court of Claims on the question of the reserve fund deduction in accordance with the established practice of this Court in such cases. (*Leader* v. *Apex Hos-*

[4] In *Finn* v. *U. S.*, 123 U. S. 227, it was held that officers of the United States may not waive the statute of limitations.

*iery Co.*, 302 U. S. 656; *Woodering* v. *Clarksburg Bridge Company*, 302 U. S. 658; *Alejandrino* v. *Quezon*, 271 U. S. 528; *Brownlow* v. *Schwartz*, 261 U. S. 216, 218; *Heitmuller* v. *Stokes*, 256 U. S. 359; *Commercial Cable Co.* v. *Burleson*, 250 U. S. 360; *Public Utilities Comrs.* v. *Compania General de Tabacos*, 249 U. S. 425; *Berry* v. *Davis*, 242 U. S. 468, 470; *U. S.* v. *Hamburg Amerikanische Co.*, 239 U. S. 466.)

Unless the Court of Claims is reversed on the reserve fund deduction issue, the petitioner may be bound in New World Life Insurance Company v. U. S., No. 44580, now pending in the Court of Claims, and also in subsequent taxable years, by the decision of that Court in the instant case, on the ground of *res judicata*, notwithstanding three Circuit Courts of Appeals have decided the identical question differently from the decision of the Court of Claims. Manifestly this would be unjust to the petitioner.

Respectfully submitted,

WALTER E. BARTON,
Investment Building,
Washington, D. C.
*Counsel for Petitioner.*

October, 1940.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1940.

---

No. 2.

---

NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

---

**On Writ of Certiorari to the Court of Claims.**

---

## PETITIONER'S MOTION FOR LEAVE TO FILE WAIVER OF STATUTE OF LIMITATIONS AND CONSENT TO JUDGMENT.

---

*To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:*

COMES Now the petitioner, New World Life Insurance Company, and respectfully moves this Honorable Court for leave to file the following Waiver of Statute of Limitations and Consent to Judgment for the reasons stated in the foregoing Brief in Opposition to Respondent's Motion to Dismiss Writ of Certiorari.

WHEREFORE, petitioner prays that its motion may be granted.

Respectfully submitted,

WALTER E. BARTON,
Investment Building,
Washington, D. C.,
*Counsel for Petitioner.*

October, 1940.

## WAIVER OF STATUTE OF LIMITATIONS AND CONSENT TO JUDGMENT.

KNOW ALL MEN BY THESE PRESENTS: That the New World Life Insurance Company, a corporation organized and existing under and by virtue of the laws of the State of Washington, and having its principal place of business in the City of Seattle in said State, does hereby waive the statute of limitations against the collection of income taxes in the amount of Fifty Dollars ($50.00) for the calendar year 1931;

And in the event that the Supreme Court of the United States in New World Life Insurance Company, Petitioner v. The United States, No. 2 October Term, 1940, in the Supreme Court of the United States, shall affirm the Court of Claims on the merits, and shall hold that the said New World Life Insurance Company is not entitled to a deduction of four per cent of the mean of Reserves for Total and Permanent Disability Benefits, Active Lives and/or Disabled Lives, held at the beginning and end of the taxable year 1931, the said New World Life Insurance Compony hereby consents to the entry of judgment in favor of the United States for income taxes in the amount of Fifty Dollars ($50.00) for said calendar year 1931.

IN WITNESS WHEREOF, the said New World Life Insurance Company has caused its corporate name to be hereunto signed by its Vice-President and its corporate seal to be hereunto affixed by its Secretary this 2nd day of October, A. D. 1940.

NEW WORLD LIFE INSURANCE COMPANY,

By EDWARD J. O'SHEA,
*Vice-President.*

ATTEST:

RUSSELL C. BURTON,
*Secretary.*

State of Washington, County of King, ss:

On this 2nd day of October, A. D. 1940, before me personally appeared Russell C. Burton, to me personally known, who, being by me first duly sworn, did depose and say that he is the Secretary of the NEW WORLD LIFE INSURANCE COMPANY; that the seal affixed to the foregoing instrument is the corporate seal of said corporation; that said instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors; and said Russell C. Burton acknowledged said instrument to be the free act and deed of said corporation.

CECELIA MCGRATH,
*Notary Public.*

(Seal)

My Commission Expires: May 23, 1942.

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**(a) "Non-Disability" policies [Death Benefits only]; and also all**

**(b) "Disability" policies [Death Benefits *combined* with Disability Benefits].**

**II. Therefore, "reserve funds" as used in § 201(a) automatically includes the $250,861.09 disputed Reserve for the Disability Benefits contained in Oregon Mutual's "Disability" policies.**

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[INTERPRETATION OF § 203(a)(2)]

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**[References required by Rules 12 and 27]**

OPINIONS BELOW: **No. 2**; *New World Life* v. *U. S.*, 26 F. Supp. 444; R32-60;

**No. 564**; *Commissioner* v. *Oregon Mutual Life*, 112 F. (2d) 314; R193; 39 B. T. A. 1239; (R43-49).

JURISDICTIONAL AUTHORITY: **No. 2**; Section 3(b) of Act of February 13, 1925, as amended May 22, 1939 [53 Stat. c. 140, p. 752].

*Certiorari* granted May 20, 1940 (R40); . . . U. S. . . .

**No. 564**; Judicial Code § 240(a) as amended by Act of February 13, 1925.

*Certiorari* granted November 12, 1940 (R192).

STATUTES INVOLVED: **No. 2**; §§ 201(a), 203(a)(2), Revenue Act of 1928 c. 852, 45 Stat. 791 at pp. 842, 843; and Revenue Act of 1932 c. 209, 47 Stat. 169 at pp. 223, 224;

**No. 564**; §§ 201(a), 203(a)(2), Revenue Act of 1932 c. 209, 47 Stat. 169, 223-4; Revenue Act of 1934 c. 277; 48 Stat. 680, 731-2.

DATE OF JUDGMENT, ETC.: **No. 2**; March 6, 1939 (R60).

**No. 564**; June 12, 1939 (R50).

NATURE OF THE CASE, RULING, ETC.: **No. 2**; *New World* case; Commissioner of Internal Revenue determined certain deficiencies in income tax for 1929-1932, against New World Life Insurance Company.

New World Life paid the deficiency taxes; and then sued the United States in the Court of Claims to recover certain parts of the deficiency taxes so paid (R1-16).

The Court of Claims held (1) that New World Life was not entitled to recover anything (R32, 60); and (2) that, while the United States was not seeking any affirmative judgment against the New World Life [because barred by the statute of limitations, R47], nevertheless, from its 1929-1932 income, New World Life had erroneously deducted 4% [3¾% for 1932] of its Active Life Reserves, and of its Disabled Life Reserves, held on account of its "contracts of *combined* life, health and accident insurance" [§§ 201(a), 203(a)(2) Revenue Acts 1928 and 1932] (R47-60).

This Court (1) denied certiorari on November 22, 1939 ... U. S. ...; (2) on December 18, 1939, granted until March 15, 1940 to file petition for rehearing; (3) on March 11, 1940, extended until May 1, 1940 time for filing petition for rehearing; (4) on May 20, 1940, granted rehearing; vacated denial of certiorari; and granted certiorari limited to the second question presented in the petition for certiorari.

**No. 564**: *Oregon Mutual* case; Commissioner of Internal Revenue determined certain deficiencies in income tax for 1933-34 against Oregon Mutual Life Insurance Company (R7-37).

Oregon Mutual petitioned the B. T. A. for a redetermination of $2,491.41 aggregate proposed income-tax-deficiencies for 1933 and 1934 (Id).

The B. T. A. decided (R43-51) and the C. C. A. (9th) *affirmed*, that Oregon Mutual was entitled to deduct $18,119.37 from its gross income, as 3¾% of the "mean of the reserve funds, required by law" for the fulfillment of its future, unaccrued, and contingent obligations [dependent upon life and disability contingencies] to pay Disability Benefits under its "contracts of *combined* life, health, and accident insurance" as allowed by §§ 201(a), 203(a)(2) of the Revenue Acts of 1932 and 1934.

Commissioner of Internal Revenue petitioned for *certiorari*, which this Court granted.

# Supreme Court of the United States

**October Term, 1940**

| | |
|---|---|
| NEW WORLD LIFE INSURANCE COMPANY, *Petitioner,* *vs.* **No. 2** UNITED STATES. | *On Writ of Certiorari to the Court of Claims* |
| COMMISSIONER OF INTERNAL REVENUE, *vs.* **No. 564** OREGON MUTUAL LIFE INSURANCE COMPANY. | *On Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit* |

## BRIEF FOR THE LIFE INSURANCE COMPANIES.

The Revenue Acts of 1932 and 1934 permitted life insurance companies to deduct, from their "gross income", 3¾% of the "mean of the *reserve funds* required by law"[1] [§ 203(a)(2)].

The only question involved here is whether, [solely with respect to their "contracts of *combined* life, health, and accident insurance"], the Companies are entitled to deduct 3¾% of the Reserve

[1] For all Benefits (i. e., Death and Disability Benefits);

or

[2] For Death Benefits only.

[1] For convenience, we will generally speak of "reserve" or "reserve funds", when strictly we are referring to "*mean of* the reserve funds", held at the beginning and end of the taxable year [§ 203(a)(2)].

For brevity, this Brief will restrict its Statement of Facts, and its Argument, to (*a*) the $1,144.34 disputed tax [1932] of New World, and (*b*) the $1,293.50 disputed tax [1934] of Oregon Mutual.[2]

The questions presented are whether New World and Oregon Mutual respectively had the right to deduct 3¾% of the "reserve funds required by law" in respect to their Disability Benefits for both Active and Disabled Lives, to-wit;

NEW WORLD LIFE [1932]

| [1] Reserve for *Disability* Benefits only | | [2] Total | [3] Deduction 3¾% of [2] | [4] Disputed Tax 13¾% of [3] |
|---|---|---|---|---|
| Active Lives | $90,725.50 | $221,932.00 | $8,322.45 | $1,144.34 |
| Disabled Lives | 131,206.50 | | | |

OREGON MUTUAL LIFE [1934]

| [1] Reserve for *Disability Benefits* only | | [2] Total | [3] Deduction 3¾% of [2] | [4] Disputed Tax 13¾% of [3] |
|---|---|---|---|---|
| Active Lives | $111,127.58 | $250,861.09 | $9,407.29 | $1,293.50 |
| Disabled Lives | $139,733.51 | | | |

[2] As the New World's 1929-'30-'31 taxes, and the 1933 Oregon Mutual tax are identical except as to amounts.

To simplify the dispute, Oregon Mutual conceded below that the deficiency notice was correct as to all items, *except* as to the $1197.91 [1933 tax] and the $1293.50 [1934 tax] (R38-43).

## RELEVANT STATUTES

[REVENUE ACT OF 1932; 47 Stat. c. 209, pp. 169, 223-4]
[REVENUE ACT OF 1934; 48 Stat. c. 277, pp. 680, 731-2]

The Revenue Acts of 1932 and 1934, first, *defined* a "life insurance company", and its gross income, as follows:

### Supplement G—Insurance Companies

SEC. 201. TAX ON LIFE INSURANCE COMPANIES.

(a) DEFINITION.—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts **(including contracts of combined life, health, and accident insurance)**, the **reserve funds** of which held for the fulfillment of **such contracts** comprise more than 50 per centum of its **total reserve funds**. . . .

SEC. 202. GROSS INCOME OF LIFE INSURANCE COMPANIES.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents. . . .

§ 201(b)(1), then, levied a 13¾% tax upon the company's "net income". Its "net income" was specifically defined as follows:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) GENERAL RULE—In the case of a life insurance company the term "net income" means the gross income *less* . . .

(2) RESERVE FUNDS—An amount equal to 4 per centum of **the mean of the reserve funds required by law** and held at the beginning and end of the taxable year, except that in the case of any such **reserve fund** which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. . . .

**The Government's Unique Construction of §§ 201, 203 is in Direct Conflict with B. T. A. and C. C. A. [1st, 5th, and 9th Circuits].**

In October 1938, the Government originated a most remarkable construction of §§ 201(a), 203(a)(2) to-wit, that "reserve funds" should be *limited* to Reserve for *Death* Benefits only; and thereby *excluded* Reserve for *Disability* Benefits (*New World Life* v. *U. S.*, 26 F. Supp. 444; here on *certiorari*, No. 2 October Term 1940).

The Court of Claims adopted that unique construction (apparently without any independent consideration, p. 18, *infra*), by incorporating into its Opinion a *verbatim* copy, or almost *verbatim* paraphrase, of the Government's Brief [See p. 19, *infra* for a parallel column illustration].

The Court of Claims' construction was not only contrary to the plain language of the Act [2a]; contrary to the Commissioner's fourteen years of uniform administrative construction [3]; contrary to the Board of Tax Appeals' settled construction [4]; contrary to the decisions in three Circuit Courts of Appeals, viz., 1st, 5th and 9th Circuits, each of which considered and summarily rejected [5] the singular views of the Court of Claims; but, most striking of all, it is directly contrary to the construction given five years ago by the same Court of Claims, and by the same five Judges in *Continental Assur. Co.* v. *U. S.*, 8 F. Supp. 474 (see p. 17, *infra*).

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[2a] § 245(a)(2) [1921], 42 Stat. 261; 1924, 43 Stat. 289; 1926, 44 Stat. 47]; § 203(a)(2) [1928, 45 Stat. 843; 1932, 47 Stat. 224; 1934, 48 Stat. 732; 1936, 49 Stat. 1711; 1938, 52 Stat. 523; 1939, 53 Stat. 865].

[3] Art. 681, Regulations Nos. 62, 65, 69; Art. 971, Regulations Nos. 74, 77.

[4] *Equitable Life Assur. Society*, 33 B. T. A. 708; *Monarch Life Insurance Co.*, 38 B. T. A. 716; *Pan-American Life Insurance Co.*, 38 B. T. A. 1430; *Oregon Mutual Life Ins. Co.*, 39 B. T. A. 1239.

[5] *Com'r* v. *Pan-American Life*, 111 F. (2d) 366; *Com'r* v. *Oregon Mutual Life*, 112 F. (2d) 468; *Com'r* v. *Monarch Life*, 114 F. (2d) 314.

## STATEMENT OF THE FACTS[6]

[NEW WORLD CASE; No. 2 OCT. TERM 1940]

1. *New World and its two kinds of policies—"Disability" and "Non-Disability".* New World is a "life insurance company" precisely as defined in § 201(a) (New World R18, 47; Government's Brief in Court of Claims p. 124).

New World issued both "Disability" and "*Non*-Disability" policies; but it never issued any *separate* "accident and health insurance" contracts (Id.).

New World calculated the Premiums and Reserves for both its "Disability" and "*Non*-Disability" policies in strict accordance with the fundamental principles governing those subjects.[7]

2. *New World's business, and the Reserves therefor.* In 1932, New World had in force both "Disability" and "*Non*-Disability" life insurance policies, for which the Reserves were as follows (§ 203(a)(2); New World R17, 29-30):

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[6] In referring to the two different kinds of policies issued by the Companies, this Brief will adopt the convenient terminology used by the New York Courts, by the Board of Tax Appeals, by the C. C. A., and by the Government, as follows:

(1) **"Disability"** policy:—providing *"combined* life, health and accident insurance", *i. e.* both Disability Benefits *and* Death Benefits.

(2) **"Non-Disability"** policy:—providing Death Benefits *only;*

[*Rhine* case, 248 App. Div. at pp. 122, 128; *Oregon Mutual* case, 39 B. T. A. 1239; 112 F. (2d) 468, 469; Government's Brief, pp. 2-3.]

A **"Disability"** policy is *not* divisible into two *separate* contracts, viz. (*a*) one of "life insurance" with Death Benefits only, and (*b*) another of "accident and health insurance" with Disability Benefits only. It is a "single integral insurance contract" (New World R17, 18, 25-26, 61; Oregon Mutual R93, 155-7; pp. 20-24, *infra*).

[7] New World R27-30; see p. 41, note [21], *infra* for full citation of leading cases.

**Table I: "Disability" Policies and "Non-Disability" Policies.**

| Policies | 1932 Reserves |
|---|---|
| "*Non*-Disability" [contracts of life insurance only] . . . | $5,000,000[8] |
| "Disability" ["contracts of *combined* life, health and accident insurance" [§ 201(a)] . . . . . | 3,348,259[8] |
| TOTAL RESERVE FUNDS . . . . . | $8,348,259[8] |

**Undisputed**

*First:* There is absolutely *no controversy* about "*Non-Disability*" policies, or

(1) The total Reserves thereon amounting to the above—**$5,000,000.**

*Second:* There is absolutely *no controversy* about "Disability" policies, in so far as the Reserve for *Death* Benefits is concerned, or

(2) $3,126,327 [**a part of** the above **$3,348,259**].

**Undisputed**

**Sole Dispute**

*Third:* The controversy in this case arises solely with respect to "Disability" policies; and, even as to them, only with respect to

(3) **$221,932** Reserve for *Disability* **Benefits** [being the *remaining part* of the above **$3,348,259** total Reserve for "Disability" policies] subdivided as shown in **Table II** below.

**Sole Dispute**

In 1932, New World's total Reserves for its *future, unaccrued* and *contingent* obligations under all its "contracts of *combined* life, health and accident insurance", *i. e.* "Disability" policies, were as follows:

[8] The total Reserve of $8,348,259 is exact (New World R17, 29-30). The apportionment thereof between "Disability" and "*Non*-Disability" Reserves is approximate only, but it will serve for illustration.

**Table II: "Disability" Policies Only.**

| Benefits | | 1932 Reserves | |
|---|---|---|---|
| Death Benefits | | $3,126,327.00[9] | |
| Disability Benefits | Active Lives | 90,725.50 | $221,932.00 |
| | Disabled Lives | 131,206.50 | |
| TOTAL | | $3,348,259.00 | |

**3.** *Government's exclusion of* **$221,932** *Reserve for Disability Benefits.* The Government contends that New World is not entitled to a deduction of 3¾% of the above **$221,932** Reserves for *Disability Benefits;*—This disputed deduction [$8,322.45] resulted in the disputed $1,144.34 tax (p. 2, *supra*).

Thus the entire controversy is over the **$221,932** Reserve for the *Disability Benefits.*

**4.** These **$221,932** Reserves for *Disability Benefits* were all concededly *"required by law"* [Government's Brief in Court of Claims, pp. 101-102; Opinion Court of Claims, New World R29-30].

**5.** *The Sole Question Involved.* In determining the amount of New World's "reserve funds" under § 203(a)(2), is the Government right or wrong in omitting the above **$221,932**?

This **$221,932** was not only *"required by law,"*; but it also was the *absolutely essential* Reserve for Disability Benefits which were an integral part of the "contracts of *combined* life, health and accident insurance" [§ 201(a)].

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[9] As there was no dispute over the $3,126,327 Reserves for the *Death* Benefits under the "Disability" policies, the Government raises no question over New World's right to a deduction of 3¾% of the above $3,126,327 Reserve for *Death* Benefits

This was because **$221,932** was the mathematically calculated measure of New World's *future, unaccrued and contingent obligations for Disability Benefits only,* for both

(*a*) *Active Lives* [$90,725.50]; *i. e.* Those policyholders who *might* become disabled *in the future;* in which event, New World would be *contingently* bound to pay Disability Benefits, to-wit, specified sums to each such disabled policyholder, as each successive yearly date arrives, *provided,* he is alive and disabled at such date (pp. 44-45, *infra*); and

(*b*) *Disabled Lives* [$131,206.50]; *i. e.* Those policyholders who had *already become disabled,* and to whom New World was *contingently* bound to pay Disability Benefits, to-wit, specified sums to each such disabled policyholder, as each successive yearly date arrives, *provided,* he is alive and disabled at such date (pp. 46-47, *infra*).

The controversy here is limited to New World's right to deduct $8,322.45, to-wit 3¾% of **$221,932.00** Reserve for *Disability Benefits* in "*Disability*" policies only (pp. 2, 6, *supra;* 8, *infra*) as to which, the following are

### 6. *The Contentions of the Parties.*

*New World's Contention.* New World contends that "reserve funds" [§ 203] embrace the entire $3,348,259—which is the mathematically calculated Reserve to meet *all* its *unaccrued* "Disability" policy obligations [for Death *and Disability*] *which are dependent upon future life and Disability contingencies* [Table I, p. 6, *supra*]—and

thereby automatically embrace the disputed **$221,932** [Table II, p. 7, *supra*].

*Government's Contention.* As to "Disability" policies, the Government contends that "reserve funds" embrace only the $3,126,327 undisputed Reserve for *Death Benefits only* [Table II, p. 7, *supra*]; and, consequently, that the 3¾% deduction allowed by § 203(a)(2) must be computed solely on the basis of such $3,126,327.

The Government reaches this $3,126,327 figure by the easy, ***but arbitrary,*** method of

FIRST: Allowing all Reserves [$3,126,327] for the *Death* Benefits in "Disability" policies; but

SECOND: *Disallowing* all Reserves [**$221,932**] for *Disability* Benefits; although such Benefits were contained in, and were an integral part of, New World's "contracts of *combined* life, health and accident insurance", which § 201(a) expressly describes as being *one kind* of "*life* insurance contracts".

*The sole issue.* At last, the sole question is whether the phrase "reserve funds" used in § 203(a)(2) includes, or does not include, the **$221,932** Reserve for Disability Benefits [p. 6, *supra;* Table II, p. 7, *supra*].

To summarize:

| "DISABILITY" POLICIES | |
|---|---|
| New World says Reserve was | $3,348,259.00 |
| Government says Reserve was [*Death* Benefits only] | 3,126,327.00 |
| Government excludes Reserve for *Disability* Benefits | $ 221,932.00 |
| Government disallows 3¾% deduction [§ 203(a)(2)] | 8,322.45 |
| Government claimed tax deficiency of 13¾% of $8,322.45 | 1,144.34 |

**7.** ***The Court of Claims' Opinion.*** **As already shown, the Court of Claims adopted the Government's construction of §§ 201(a), 203(a)(2) p. 4, *supra;* and decided against New World (New World R32, 46-60; 26 F. Supp. 444). A review of its Opinion will be postponed until after stating the facts in the *Oregon Mutual* case (See p. 17, *infra*).**

# STATEMENT OF FACTS

**No. 564. October Term, 1940**

***Commissioner of Internal Revenue* v. *Oregon Mutual Life Ins. Co.*, 112 F. (2d) 468**

# STATEMENT OF FACTS

No. 864. October Term, 1940

Commissioner of Internal Revenue v. Oregon Mutual
Life Ins. Co., 112 F. (2d) 468

## STATEMENT OF FACTS [6]

[OREGON MUTUAL CASE; No. 564 OCT. TERM 1940]

**1.** ***Oregon Mutual and its two kinds of policies—"Disability" and "Non-Disability".*** Oregon Mutual is a "life insurance company" precisely as defined in § 201(a) (Oregon Mutual R47; Government's Brief in C. C. A. p. 8).

Oregon Mutual issued both "Disability" and "*Non*-Disability" policies; but it never issued any *separate* "accident and health insurance" contracts (Oregon Mutual R93).

Oregon Mutual calculated the Premiums and Reserves for both its "Disability" and "*Non*-Disability" policies in strict accordance with the fundamental principles governing those subjects.[10] [B. T. A.'s Findings, Oregon Mutual R45, 46; See illustrative Tables A, B, and D, Oregon Mutual R79, 91, 110.]

**2.** ***Oregon Mutual's business, and the Reserves therefor.*** In 1934, Oregon Mutual had in force a total of about 25,000 "Disability" and "*Non*-Disability" life insurance policies, for which the $10,025,706.38 Reserves were as follows [§ 203(a)(2); Oregon Mutual R44-46, 64, 65; Government's Brief in C. C. A. pp. 2-4]:

**Table I: "Disability" Policies and "*Non*-Disability" Policies.**

| Policies | 1934 Reserves |
|---|---|
| "*Non*-Disability [contracts of life insurance only] | $6,093,400.64 |
| "Disability ["contracts of *combined* life, health and accident insurance" (§ 201(a))] | 3,932,305.74 |
| TOTAL RESERVE FUNDS | $10,025,706.38 |

[6] See note [6] p. 5, *supra.*

[10] Oregon Mutual R67-116; see p. 41, note [21], *infra* for full citation of leading cases.

Undisputed

*First:* There is absolutely *no controversy* about "*Non-Disability*" policies, or

(1) The total Reserves thereon amounting to the above—**$6,093,400.64.**

*Second:* There is absolutely *no controversy* about "Disability" policies, in so far as the Reserve for *Death* Benefits is concerned, or

(2) $3,681,441.65 [**a part of** the above **$3,932,305.74**].

Undisputed

Sole Dispute

*Third:* The controversy in this case arises solely with respect to "Disability" policies; and, even as to them, only with respect to

(3) **$250,861.09** Reserve for *Disability* **Benefits**[11] [being the *remaining part* of the above **$3,932,305.74** total Reserve for "*Disability*" policies] subdivided as shown in **Table II** below (Oregon Mutual R42, 45, 65, p. 2, *supra*).

Sole Dispute

In 1934, Oregon Mutual's $3,932,305.74 Reserves for its *future, unaccrued* and *contingent* obligations under all its "contracts of *combined* life, health and accident insurance", *i. e.* "Disability" policies, were as follows (Id.).

[11] B. T. A. Opinion Oregon Mutual R44, note 3, 46; Government's Brief in C. C. A., pp. 2-3.

**Table II: "Disability" Policies Only.**

| Benefits | | 1934 Reserves | |
|---|---|---|---|
| Death Benefits | | $3,681,444.65 [12] | |
| Disability Benefits | Active Lives | 111,127.58 | $250,861.09 |
| | Disabled Lives | 139,733.51 | |
| | TOTAL | $3,932,305.74 | |

**3.** *Commissioner's exclusion of* **$250,861.09** *Reserve for Disability Benefits.* The Commissioner *disallowed* a deduction of 3¾% of the above **$250,861.09** Reserves for *Disability Benefits;*—This disallowed deduction [$9,407.29] resulted in the $1,293.50 tax deficiency (p. 2, *supra,* Government's Brief in C. C. A. p. 4, Table).

Thus, the entire controversy is over the **$250,861.09** Reserve for the *Disability Benefits,* which Benefits are an integral part of the *policies* specifically designated in § 201(a) as "contracts of *combined* life, health and accident insurance", *i. e.,* "Disability" policies (pp. 2, 12, *supra*).

**4.** These **$250,861.09** Reserves for Disability *Benefits* were all expressly concededly *"required by law"* [Government's Brief in C. C. A., pp. 3, 22; B. T. A.'s Findings Oregon Mutual R47, 139; C. C. A.'s Opinion, 112 F. (2d) at p. 469].

**5.** *The Sole Question Involved.* In determining the amount of Oregon Mutual's "reserve funds" under § 203(a)(2), was the Commissioner right or wrong in omitting the above **$250,861.09**?

This **$250,861.09** was not only *"required by law,"*; but it also was the *absolutely essential* Reserve for Disability Benefits which were an integral part of the "contracts of *combined* life, health and accident insurance" [§ 201(a)].

[12] As there was no dispute over the $3,681,444.65 Reserves for the *Death* Benefits under the "Disability" policies, the Commissioner properly allowed a deduction of 3¾% of the above $3,681,444.65 Reserve for *Death* Benefits (B. T. A. Opinion, Oregon Mutual R46; Government's Brief in C. C. A., p. 3).

This was because **$250,861.09** was the mathematically calculated measure of Oregon Mutual's *future, unaccrued and contingent obligations for Disability Benefits only,* for both

(*a*) *Active Lives* [$111,127.58]; *i. e.* Those policyholders who *might* become disabled *in the future;* in which event, Oregon Mutual would be *contingently* bound to pay Disability Benefits, to wit, specified sums to each such disabled policyholder, as each successive yearly date arrives, *provided,* he is alive and disabled at such date (pp. 44-45, 48, *infra;* and

(*b*) *Disabled Lives* [$139,733.51]; *i. e.* Those policyholders who had *already become disabled,* and to whom Oregon Mutual was *contingently* bound to pay Disability Benefits, to-wit, specified sums to each such disabled policyholder, as each successive yearly date arrives, *provided,* he is alive and disabled at such date (pp. 46-48, *infra*).

The controversy here is limited to Oregon Mutual's right to deduct $9,407.29, to-wit 3¾% of **$250,861.09** Reserve for *Disability Benefits* in "*Disability*" policies only (pp. 2, 12, 13, *supra;* 43-49, *infra*), as to which, the following are

### 6. *The Contentions of the Parties.*

*Oregon Mutual's Contention.* Oregon Mutual contends that "reserve funds" [§ 203(a)(2)] embraces the entire $3,932,305.74—which is the mathematically calculated Reserve to meet *all* its *unaccrued* "Disability" policy obligations [for Death *and Disability*] *which are dependent upon future life and Disability contingencies* [Table I, p. 11, *supra*] and thereby automatically embraces the disputed **$250,861.09** [Table II, p. 13, *supra*].

*Commissioner's Contention* As to "Disability" policies, the Commissioner contends that "reserve funds" embraces

only the $3,681,444.65 undisputed Reserve for *Death Benefits only* [Table II, p. 13, *supra*]; and, consequently, that the 3¾% deduction allowed by § 203(a)(2) must be computed solely on the basis of such $3,681,444.65 [Government's Brief in C. C. A. pp. 3, 5-6].

The Commissioner reached this $3,681,444.65 figure by the easy, *but arbitrary*, method of

FIRST: Allowing all Reserves [$3,681,444.65] for the *Death* Benefits in "Disability" policies; but

SECOND: *Disallowing* all Reserves [**$250,861.09**] for *Disability* Benefits; although such Benefits were contained in, and were an integral part of, Oregon Mutual's "contracts of *combined* life, health and accident insurance" which § 201(a) expressly described as being *one kind* of "*life* insurance contracts".

*The sole issue.* At last, the sole question is whether the phrase "reserve funds" used in § 203(a)(2) includes, or does not include, the **$250,861.09** Reserve for Disability Benefits [pp. 2, 12, note *supra;* Table II, p. 13, *supra*].

To summarize:

| "DISABILITY" POLICIES | |
|---|---|
| Oregon Mutual says Reserve was | $3,932,305.74 |
| Commissioner says Reserve was [*Death* Benefits only] | 3,681,444.65 |
| Commissioner excluded Reserve for *Disability* Benefits | **$ 250,861.09** |
| Commissioner disallowed 3¾% deduction [§ 203 (a)(2)] | $ 9,407.29 |
| Commissioner asserted tax deficiency of 13¾% of $9,407.29 | $ 1,293.50 |

**7.** *The B. T. A.'s Findings of Fact (R44-47).* The Board of Tax Appeals' Findings of Fact were, that,

I. Oregon Mutual's $111,127.58 Active Life Reserve was designed "to meet **future, unaccrued and contingent** lia-

bilities under those disability policies the holders of which have not incurred disabilities" (Oregon Mutual R45, 46);

II. Oregon Mutual's $139,733.51 Disabled Life Reserve was designed to enable Oregon Mutual "to pay disability benefits **to become due in the future** as long as the disabled policyholder **remains alive** and disabled" (Id.); and

III. "There is no duplication between these two reserves" (Id.).

## B. T. A. Decision

**8.** *The B. T. A.'s Decision.* In accordance with its elaborately considered prior opinions, the Board of Tax Appeals decided [13] (Oregon Mutual R43, 47-49);

I. Active and Disabled Life Reserves are "reserves required by law" within the meaning of § 203(a)(2);

II. Oregon Mutual was entitled to deduct $9,407.29 from its "gross" income, as 3¾% of the **$250,861.09** Active and Disabled Life Reserves; and it did not owe the $1,293.50 alleged tax deficiency for 1934.

## C. C. A. Decision

**9.** *C. C. A. Decision* [*Com'r* v. *Oregon Mutual,* 112 F. (2d) 468]; The C. C. A. (9th) affirmed the B. T. A.'s decision (R193).

On November 9, 1940, the Commissioner petitioned for *certiorari,* which was granted on November 12, 1940.

[13] *Equitable Life Assurance Society,* 33 B. T. A. 708; and *Monarch Life Ins. Co.,* 38 B. T. A. 716; *Pan-American Life Ins. Co., Id.* 1430, which, with the case at bar, have since been respectively *affirmed* by the C. C. A. (1st, 5th, 9th) in 114 F. (2d) 314; 111 F. (2d) 366; and 112 F. (2d) 468.

## 10. Court of Claims' Opinion in New World Life Case. [26 F. Supp. 444: R32-60]

The Court of Claims held that the term "reserve funds" in § 203(a)(2),

[1] *Included* all Reserves for Death Benefits—a conclusion with which all the Courts are agreed; but

[2] *Did not include* the Reserves held for the fulfillment of a life insurance company's obligation to pay Disability Benefits, included in "contracts of *combined* life, health and accident insurance".

The Court of Claims' conclusion is,

(*a*) **Directly contrary** to the decisions of the Board of Tax Appeals, reached in a series of carefully considered opinions, spread over five years, and delivered by three different members of the B. T. A., unanimously concurred in by twenty-two other different members of the B. T. A.; and

(*b*) **Directly contrary** to the decision of three different Circuit Courts of Appeals (1st, 5th and 9th), representing the unanimous judgment of eight Circuit Judges and one District Judge, whose opinions showed a thorough understanding of all the technical features involved, their careful consideration, and a consistent result.

*Furthermore,* the Court of Claims' decision by LITTLETON, J. (concurred in by BOOTH, GREEN, WHALEY and WILLIAMS, JJ.) is unconsciously in direct conflict with the same Court of Claims' prior decision in *Continental Assur. Co.* v. *U. S.,* 8 F. Supp. 474, rendered by exactly the same five Judges. In the *Continental* case, the Court of Claims held that "reserve funds" in § 245(a)(2) [which is identical with § 203(a)(2) of the 1932 Revenue Act] was *not*

restricted to reserves for Death Benefits only, but that it included all technical insurance reserves "to meet existing unmatured insurance, **whether fire, marine or life insurance**" (pp. 51-52, *infra*).

The Court of Claims' new and contrary Opinion should not be given any independent weight here, because:

1. That part of its Opinion construing "reserve funds", as used in § 203(a)(2), does not represent its own consideration and determination of the subject (New World R46-59).

This is shown by two circumstances:

(*a*) The Court of Claims did not simply *overlook* the *Continental Assur. Co.* case, as it was cited and relied on (New World R53, 57, 59). Nevertheless in the *New World* case, the Court gave to the words "reserve funds" in § 203(a)(2) a meaning which was directly in conflict with the meaning which (in the *Continental* case five years before), it had given to those same words in the same section.

(*b*) As its Opinion in the *New World* case, the Court of Claims adopted practically a *verbatim* copy of the Government's Brief on the subject of "reserve funds". As that Brief did not call attention to the obvious conflict between the prior construction of "reserve funds" in the *Continental* case, and the new construction which the Government was urging the Court of Claims to adopt, the latter apparently failed to notice the conflict, **and unconsciously overruled its former decision.**

The following parallel column comparison indicates the extent to which the Court of Claims' Opinion was a mere adoption of the Government's Brief:

| Identic or almost identic language in | |
|---|---|
| Opinion of Ct. of Claims [26 F. Supp. 444] | Government's Brief in Ct. of Claims |
| Page | Page |
| 460 | 105, 106, 123 |
| 461 | 123-126 |
| 462 | 126-129 |
| 463 | 129-132 |
| 464 | 132-135 |
| 465 | 135-137 |
| 466 | 137-140 |

2. The Court of Claims' Opinion, as copied from the Government's Brief, rests on several fundamental errors of fact, which vitiate, and render unnecessary any detailed refutation of its involved reasoning; which errors may be briefly summarized as follows:

(a) The Court of Claims' Opinion arbitrarily calls all "accident and health" insurance, "*casualty* insurance", and calls the Reserves therefor "casualty reserves" some *sixteen times* [see pp. 460-465; New World R46-57].

The Opinion then treats such so-called "*casualty*" insurance, as if it were always contained in a *separate policy* wholly distinct from, and independent of, life insurance [Death Benefits], thereby simply ignoring Congress's recognition of, and express provision for

> "life insurance and annuity contracts (*including* contracts of *combined* life, health and accident insurance)" [§ 201(a)],

as "unimportant" (p. 465; New World R56).

The Opinion thus ignores as "unimportant" the vital fact that there *are* (1) *separate* "accident and health" policies, and also (2) *combined* life, health and

accident policies—the existence of which two different kinds of policies are recognized and separately provided for in § 201(a) (pp. 28, 33-37, *infra*),

(*b*) The Court of Claims' Opinion is guilty of a plain *error* of fact, as well as of law, when it says (p. 465; New World R56);

> "The health and accident portion of the combined policies are entirely *separate contracts, New York Life Ins. Co.* v. *U. S.*, 12 F. (2d) 643.[14] . . . . The specimen policy in evidence in this case shows that with the page covering casualty insurance *removed* it is a complete life insurance policy . . . The two contracts are as separate and distinct as if written in separate policies."

*This is simply not a fact.* While a physical removal of the page entitled "Total and Permanent Disability Benefits" from the New World policy would leave a "complete life insurance policy" (R66);—**the converse is absolutely false.** If "the page covering casualty insurance [were] removed", **no "casualty insurance" would remain;** and the casualty insurance contract is *not* "as separate and distinct as if written in a separate policy". This is because [as so forcibly pointed out in both the *Rhine* and *Rubin* cases, pp. 22-24, *infra*], there would be no identifiable *insurance company*; no

[14] *New York Life* v. *U. S.*, 12 F. (2d) 643, does not support what the Court of Claims cites it for. In that case, Congress imposed *one kind of tax* upon the *face amount* of life insurance [Death Benefits], and a *different kind of tax* upon the *premiums* charged for Disability Benefits and Accident Benefits. New York Life issued a policy containing both Death, Disability and Accident benefits. The Company contended that when it paid the tax upon the *face amount* of the policy, it was exempt from the further tax on the *premiums* charged for Disability and Accident Benefits. The Court (MANTON, J.) held that the payment of the tax on the *face amount* of the policy, did not relieve the company from also paying a different tax upon the *premiums* charged for Disability and Accident Benefits. Nothing else was involved in the case and it has no application whatever in determining what Congress meant by "reserve funds".

identifiable *policyholder*; no identifiable *person to receive the income benefit* due at the unidentifiable policyholder's death; no identifiable *"grace period"*; no identifiable *amount of the premium waived* in the event of disability; no identifiable *amount which is to be deducted* under certain conditions from the Disabilty Benefits; no identifiable *date* of the policy; no identifiable *date* when the premium for the Disability Benefit is payable, or the *days of grace* allowed for its payment; no identifiable *date* when the unidentifiable policyholder *may discontinue* the Disability Benefits and thereby reduce the amount of his premium; no identifiable *date* of the policy *from which to determine* whether the disability is covered; no identifiable *beneficiary* to receive the monthly income in the event of the unidentifiable policyholder's mental incapacity, etc.

Those vital omissions from New World's "page covering casualty insurance" demonstrate that the so-called casualty insurance contract is not as "separate and distinct as if written in a separate policy"; but the so-called casualty insurance is utterly "meaningless" and "unintelligible" except when read *as an integral part* of the life insurance provisions of the policy. Those are the reasons why the New York and California Courts have held that such a "Disability" policy is

> "a single policy, with both 'Death and Disability' benefits so interwoven as to constitute **a single integral insurance contract**";

and that if the accident and health provisions were

> "taken together **apart** from the rest of the policy it would be impossible to spell out a separate contract for disability insurance"; they are **"unintelligible** without the death benefit provisions"; are **"incomplete and meaningless** . . . and fail to disclose most of the essential terms"; and the life, accident and health provisions **"constitute a single instrument, both by**

**physical union and in legal effect"** [See pp. 22-24, 58-60, *infra*].

In *Rhine* v. *New York Life Insurance Co.*, 248 App. Div. 120; 273 N. Y. 1 the New York Life's "Disability" policy of "*combined* life, health and accident insurance" contained both Death Benefits and Disability Benefits, with a provision that the insured might, at any time, discontinue the Disability Benefits, and thereafter the premium payable should be reduced by the amount charged for the Disability Benefits. That case involved the question whether a "Disability" policy was *one* contract, or consisted of *two* contracts—one for *life* insurance, and the other for *disability* insurance.

In rejecting Mrs. Rhine's contention [which is the Government's contention here] that the policy consisted of *two* complete agreements of insurance, *one* for life insurance and *the other* for disability insurance, the Appellate Division said (pp. 133-135):

> "We reach the conclusion that the policy is one agreement, a single policy, with both death and disability benefits so interwoven as to constitute **a single integral insurance contract** • • • A consideration of the provisions for disability benefits makes it clear that if all of these provisions were taken together apart from the rest of the policy, it would be impossible to spell out a separate contract for disability insurance; there would be no identifiable company, no identifiable sum to be paid (for the disability benefits cannot be obtained without the death benefit), and no identifiable person to receive the payment. The provisions for disability benefits are so intimately dependent upon and unintelligible without the death benefit provisions as to be by themselves impossible of constituting a separate contract. • • • A single set of promises arising in connection with life insurance and with disability insurance are

> closely interwoven and dependent one upon the other. The disability benefits are issued only when the terms thereof are printed in a life insurance policy, they cannot be obtained separately and cannot be continued in force independently of the death benefit in the policy. * * * **the policy is a single contract** containing various provisions and various promises * * * but the policy cannot be taken, as plaintiff contends, as the equivalent of two separate policies, one the exact equivalent of a policy of life insurance with merely a death benefit, and the second an independent contract or policy covering disability benefits. * * * were the life insurance provision stricken out at the outset there would have been no contract whatever, as disability benefits are issued only when the terms thereof are printed in a life insurance policy; they cannot be separately obtained."

In affirming the Appellate Division, the Court of Appeals acutely analyzed the nature of both "Disability" and "*Non*-Disability" policies and held that the Death Benefits and Disability Benefits were "integral parts of a single policy" (273 N. Y. at p. 15). The Court (LEHMAN, J.) also said (p. 7):

> " . . . the aggregate premiums received by the company and the interest earned on its investments create one general fund from which are paid the death and *disability* claims, endowments, surrender value and other claims, the expense of conducting the business, including depreciation in investment values, and all other obligations of the company; and out of which also the reserves are maintained."

In *Rubin* v. *Metropolitan Life Insurance Co.*, 251 App. Div. 382; 278 N. Y. 625, the Disability Benefits were even printed in a separate "rider" form entitled "Supplementary Contract" separately dated, signed by the company officials, and pasted on the policy, [instead of being contained in a *paragraph* of the life insurance policy, as in the Oregon Mutual (R155-7), New World, and New York Life].

Even in such a case of a *separate* "rider" providing for Disability Benefits, the Appellate Division, affirmed by the Court of Appeals, said:

> "The distinction, however, is one of form only. No difference exists between the two methods of including disability benefits in a policy of life insurance.
>
> In neither case do the disability provisions constitute separate contracts of insurance, • • •. • • • if the life insurance should lapse, the disability benefits would not survive nor could they be continued. The disability "rider," taken alone, is incomplete and meaningless and, except by reference to the remaining provisions of the policy, fails to disclose most of the essential terms. Moreover, the policy describes itself many times as a single policy. These circumstances, without reference to many others, require the conclusion that the policy, together with the "Supplementary Contract," constitute a single instrument, both by physicial union and in legal effect."

In *Barnett* v. *Metropolitan Life Insurance Co.*, 16 N. Y. S. (2d) 198, the *Rhine* and *Rubin* cases are reaffirmed, the Court saying that the policies were "ordinary life policies *containing what are commonly termed disability benefits*". [See authorities cited p. 59 note [21], *infra*.]

**The Court of Claims' fundamental error in assuming that a so-called "Disability" policy really consists of two independent contracts, leads it into a totally erroneous, and utterly unjustifiable, interpretation of the plain language of § 201(a)** (pp. 28, 32-35, *infra*),—**resulting in a still further error in its interpretation of § 203(a)(2), based in turn upon the wrong interpretation of § 201(a).** [Cf. pp. 461-2, 463; New World R47-53.]

## SUMMARY OF POINTS DISCUSSED.

### I. [Interpretation of § 201(a)]

**1. In § 201 (a), the phrase "reserve funds . . . held for the fulfillment of such contracts" is not restricted [as the Commissioner contends it is] to Reserve for Death Benefits only; but it includes the entire Reserve held for the fulfillment of**

**(a) "Non-Disability" policies [Death Benefits only];**

**and also all**

**(b) "Disability" policies [Death Benefits *combined* with Disability Benefits].**

**2. Therefore, "reserve funds" as used in § 201(a) automatically includes the $250,861.09 disputed Reserve for the Disability Benefits contained in Oregon Mutual's "Disability" policies.**

**3. The Commissioner's interpretation of § 201(a)—which is contrary to the settled interpretation by the B. T. A., and by the C. C. A. (1st, 5th and 9th)—must be rejected (pp. 27-37).**

### II. [Nature of "Technical Insurance Reserves"]

**1. In § 203(a)(2), the words "reserve funds" refer to *technical insurance reserves, i. e.* reserves held to meet a life insurance company's obligations which are entirely (a) future, (b) unaccrued, and (c) dependent upon life contingencies, or (d) dependent upon a series of life and disability contingencies.**

**2. For 1934 Oregon Mutual's $3,932,305.74 Reserve for "Disability" policies [including the disputed $250,861.09 Reserve for the Disability Benefits] was**

**the *technical insurance reserve*, mathematically calculated as the then measure of its liability for the performance of only future, unaccrued and contingent policy obligations [Death and Disability Benefits] (pp. 38-49).**

**III.** [INTERPRETATION OF § 203(a)(2)]

**In § 203(a)(2), the phrase "reserve funds" is not restricted to Reserve for Death Benefits only [as the Commissioner contends], but it also includes Oregon Mutual's $250,861.09 Active and Disabled Life Reserve for the Disability Benefits [contained in the 10,000-odd "Disability" policies], which $250,861.09 the Commissioner erroneously excluded when calculating the authorized 3¾% deduction (pp. 50-85).**

## FIRST POINT.*

[INTERPRETATION OF § 201(a)]

**I. In § 201(a), the phrase "reserve funds . . . held for the fulfillment of such contracts" is not restricted [as the Commissioner contends it is] to Reserve for Death Benefits only; but it includes the entire Reserve held for the fulfillment of**

**(a) "Non-Disability" policies [Death Benefits only]; and also all**

**(b) "Disability" policies [Death Benefits *combined* with Disability Benefits].**

**II. Therefore, "reserve funds" as used in § 201(a) automatically includes the $250,861.09 disputed Reserve for the Disability Benefits contained in Oregon Mutual's "Disability" policies.**

**III. The Commissioner's interpretation of § 201(a) —which is contrary to the settled interpretation by the B. T. A., and by the C. C. A. (1st, 5th and 9th)—must be rejected.**

§ 201(a) provided:

> "(a) DEFINITION.—When used in this title the term '*life* insurance company' means an *insurance* company engaged in the business of issuing life insurance and annuity contracts (*including contracts of combined life, health, and accident insurance*), the *reserve funds* of which *held for the fulfillment of such contracts* comprise more than 50 per centum of its *total reserve funds.*"

§ 201(a) admittedly refers only to "technical insurance reserves".[15]

* In view of the identity of the questions in the *New World* and *Oregon* cases, and in order to save this Court's time and labor, the Argument will be based on Oregon Mutual's 1934 disputed $1,293.50 tax. Unless otherwise indicated, all subsequent references to the Record will be to the Record in the *Oregon Mutual* case.

[15] Refer to bottom of p. 28 for this note.

**I. Proper Construction of § 201(a).**

§ 201(a) thus expressly defines a "*life* insurance company" as "an *insurance* company"

**[A]** "issuing life insurance and annuity contracts (*including* contracts of *combined* life, health and accident insurance),

This clause **[A]** embraces *every kind* of life insurance policies—both "Disability" policies as well as "*Non*-Disability" policies.

**[B]** the reserve funds of which held for the fulfillment of *such contracts*

This clause **[B]** refers to the "reserve funds" held for *all* life insurance policies, *i. e.*, both the above described "Disability" policies, and, "*Non*-Disability" policies—all as designated in **[A]**.

**[C]** comprise more than 50 per centum of its *total reserve funds*".

This clause **[C]** establishes a ratio between **[B]**—the "reserve funds" already designated as held for both "Disability" and "*Non*-Disability" policies, —and **[C]**—"its *total* reserve funds", *i. e.*, reserve funds for "Disability" policies, and "*Non*-Disability" policies, *plus* the reserve funds for *every other type* of insurance, *if any*, which the "insurance" company has outstanding.

[15] See pp. 39 note [20], 41-42, *infra; New World Life* v. *U. S.*, 26 F. Supp. 444, 462 [Ct. Cls.]; *Com'r* v. *Oregon Mutual Life*, 112 F. (2d) 468, 470 (C. C. A. 9th); *Com'r* v. *Monarch Life*, 114 F. (2d) 314, 324-5 (C. C. A. 1st); Government's Brief in C. C. A., p. 19.

These parallel columns show, at a glance, that the phrase "reserve funds" in [**B**] necessarily includes [contrary to the Commissioner's contention] the Reserve for *Disability* Benefits in "contracts of *combined* life, health and accident insurance", *as well as* the Reserve for *Death* Benefits.

In *Pan-American Life Insurance Co.*, 38 B. T. A. 1430, 1440, the B. T. A., properly construed § 201(a) saying:

> "In this definition there can be no doubt but that Congress intended the term 'reserve funds' to apply to 'contracts of combined life, health and accident insurance' as well as to 'life insurance and annuity contracts.' "

The C. C. A. (9th) held the same thing in *Commissioner* v. *Oregon Mutual Life* 112 F. (2d) 468, 470 saying:

> "Considerable light is thrown on the problem by the provisions of § 201(a) of the act. . . .
>
> As applied, for example, to this taxpayer, the Commissioner construes the statute as meaning that the determinative ratio is between the *non*-disability elements of the company's reserves and a total comprising these *plus* the reserves held for the fulfillment of the disability features of its *combined* policies.
>
> The statute, however, says that the reserve funds which are to be compared with the total shall comprise reserves held 'for the fulfillment of such contracts'—namely, the contracts enumerated. These expressly include 'contracts of *combined* life, health, and accident insurance'. For the purpose of classification, the disability reserves held against the *combined* policies are treated by the act as *life* insurance reserves. Neither the Commissioner nor the court is at liberty to disregard the plain language of the section on the theory that the classification lacks philosophical basis. It must be borne in mind that we are dealing with a statute, not with an actuarial problem."

This *correct* construction of § 201(a) destroys the Commissioner's construction, which *erroneously assumes* that

the phrase—"reserve funds *of which* . . . "—includes only reserve for *Death* Benefits, but *not* reserve for *Disability* Benefits—even when *"combined"* with life insurance.

**The Government's erroneous construction—absolutely contradictory to the plain language of § 201(a)—vitiates its subsequent construction of § 203(a)(2), which construction, in turn, is solely based upon its prior erroneous interpretation of § 201(a).**

### II. "Reserve funds" under § 201(a) includes Oregon Mutual's $250,861.09 Reserve for Disability Benefits.

Oregon Mutual was a *life* insurance company, and *taxable as such* under §§ 201-203, *solely because* its Reserve for "Disability" and "*Non*-Disability" policies was "more than 50%" of its "total reserve funds" *i. e.* it was 100% (pp. 3, 11-13, *supra*, Cf. R65, 93), to wit:

On December 31, 1934, Oregon Mutual's "reserve funds . . . held for the fulfillment of *such contracts*" [to wit for "life insurance and annuity contracts (*including* contracts of *combined* life, health and accident insurance)"], were $10,025,706.38 subdivided as follows (Tables I and II, pp. 11, 13, *supra*):

| | | | Reserve |
|---|---|---|---|
| [A] | "*Non*-Disability" policies (Death Benefits only) | | $6,093,400.64 |
| | "Disability" policies: | | |
| | Death Benefits only | $3,681,444.65 | |
| | Disability Benefits {Active Lives $111,127.58; Disabled Lives 139,733.51} | 250,861.09 | 3,932,305.94 |
| [B] | Reserve funds for "Disability" and "*Non*-Disability" policies | | $10,025,706.38 |
| [C] | Oregon Mutual's "TOTAL RESERVE FUNDS" | | $10,025,706.38 |

The ratio of "[B]" to "[C]" is thus 100%[16]; and since such ratio was "more than 50%," Oregon Mutual thereby

[16] This ratio is 100% for Oregon Mutual only because, like many other companies, it *never* issued any *separate* "accident and health

(*Continued on p. 31*)

was a "*life* insurance company" as defined in § 201(a) [pp. 3, 11, *supra*].

The "reserve funds . . . held for the fulfillment of such contracts" **[B]**, as well as the "total reserve funds" **[C]**, automatically included the **$250,861.09** Reserve for *Disability* Benefits in controversy here.

### III. The Government's interpretation of § 201(a) is purely arbitrary and must be rejected.

The Government repeatedly misconstrues § 201(a) in two respects;

*First;* It erroneously construes § 201(a) to require a comparison between (1) Reserves for all *Death Benefits* (*part* of **[B]**), and (2) Total Reserves **[C]**; *whereas,* § 201(a) requires a comparison between (1) Reserves for *all Death and all Disability Benefits* (*all* of **[B]**), and (2) Total Reserves **[C]** (see p. 28, *supra*);

*Second;* It disregards the *distinction* between (1) *separate* "health and accident" insurance, and (2) "health and accident" insurance *in combination with* life insurance, *i. e. Disability* Benefits in "Disability" policies [§ 201(a)].

The Government's construction must be promptly rejected, for the following reasons:

(1) It directly conflicts with the plain and unambiguous language of § 201(a) as analyzed at page 28, *supra;*

(2) It construes § 201(a) *as if it contained,* [which it does *not* contain], the following *italicized* words, *i. e.*

> "held for the fulfillment of *the Death Benefits only in* such contracts";

(*Continued from p. 30*)
insurance". In the case of those companies which issued *separate* "accident and health insurance" however, this ratio of **[B]** to **[C]** may, or may not, be "more than 50%" of their "total reserve funds", depending entirely upon the extent of their *separate* "accident and health" business (*Monarch Life Insurance Co.,* 38 B. T. A. 716; Id. 801; *Com'r* v. *Monarch Life,* 114 F. (2d) 314).

*whereas,* § 201(a) used no such limiting words; but it used the all-embracing phrase "held for the fulfillment of *such* contracts". It thereby directly referred to contracts of "*combined* life, health and accident insurance", as well as to "*Non*-Disability" policies (see **[B]**, pp. 28-31, *supra*);

(3) It erroneously assumes that Oregon Mutual's "Disability" policies consisted of two entirely *separate* contracts (a) one of "life" insurance only, and (b) another of "accident and health" insurance *only,*—as separate and distinct as if written in two entirely separate policies; and that the Disability Benefits, [which are an integral part of Oregon Mutual's "contracts of *combined* life, health and accident insurance," *i. e.* "Disability" policies,] constitute a *separate* "accident and health insurance" contract.

The Court of Claims said (26 F. Supp. at p. 465):

> "The health and accident portion of the combined policies are *entirely separate* contracts, *New York Life Ins. Co.* v. *U. S.*, 12 F. (2d) 643.[17] . . . The specimen policy in evidence in this case shows that with the page covering casualty insurance *removed* it is a complete life insurance policy . . . The two contracts are as *separate and distinct* as if written in separate policies."

**This is simply not a fact** [See pp. 20-24, *supra;* 33, 58-60, *infra.*]

In Oregon Mutual's policy, all the provisions for "Disability Benefits" are contained in one Paragraph, XIV, *printed in* the policy just as the other fifteen Paragraphs are printed, covering "Loans and Surrender values", "In-

[17] See p. 20 note [14] *supra* which distinguishes *New York Life* v. *U. S.*

contestability", "Settlement at maturity of policy", "Policy and Application the Entire Contract", etc. Paragraph XIV could not be *physically removed* from the policy [as the Court of Claims indicated that "the page covering casualty insurance [might be] removed" leaving "a complete life insurance policy"] because Paragraph XIX was not on a page by itself. If Paragraph XIV were cut out with a pair of scissors, then the copy of the Application (on the *reverse* side of the page) would be mutilated beyond recognition. This would destroy the contract itself by physically emasculating a copy of the Application, which, by Statute, *must be a part of the contract.*

On the other hand, if instead of cutting out Paragraph XIV with scissors, it should merely be obliterated by lines drawn through it, there would be no Disability Benefits whatever (see pp. 20-24, *supra*).

Oregon Mutual's "Disability" policies are **single integral insurance contracts**, in which the Disability Benefits are so intimately interwoven with the Death Benefits, that it is impossible to spell out a disability contract of insurance by itself. That which the Government constantly calls a "contract of accident or health insurance" *is utterly meaningless standing alone* and does not exist independently [Cf. R155-7; See pp. 20-24, *supra*, for a full discussion].

(4) The Government's interpretation completely ignores Congress' reason for carefully defining the ratio, by which to determine whether an *insurance* company is a *life* insurance company, or is a company "*other* than life" as will now be fully explained:

For many years both prior to, and since 1921, *insurance* companies—[not limited to *life* insurance companies]—have issued one or more of various kinds of insurance policies providing for (R67-69, 116-120),

(*a*) *Death* Benefits *only*—here called "*Non*-Disability" policies;

(*b*) Death *and* "Disability" Benefits ["accident and health"] *combined* in one policy—here called "Disability" policies. The Disability Benefits have always been a mere incidental part of the whole "Disability" policy (R93, 155-7).

(*c*) Accident and Health Benefits *only*—contained in an *independent, separate contract,* having no connection with life (Death Benefit) insurance; and commonly called "accident and health" insurance [Oregon Insurance Laws § 46-117 (2) *Third; Travellers Equitable Ins. Co.* 22 B. T. A. 784; *Monarch Life Ins. Co.* 38 B. T. A., 716; *Id.* 801; *Mass. Protective Ass'n. of U. S.* 114 F. (2d) 304 (C. C. A. 1st); *Com'r* v. *Monarch Life* 114 F. (2d) 314, 318-322].[18]

In 1921 [because of the peculiar nature of life insurance], Congress divided all insurance companies into three distinct and mutually exclusive "Classes", to wit:

Class I: *Life* insurance companies [whether mutual or stock companies; §§ 201-203];

Class II: *Mutual* insurance companies [*other* than *life;* § 207];

Class III: *Stock* insurance companies [*other* than *life;* § 204]

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[18] Insurance companies also wrote:

(*d*) Other Benefits, such as Fire, Marine, Automobile, Workmen's Compensation, Credit Indemnity, Plate Glass, Burglary, Theft, etc. [In the United States, differently from England, the same insurance company rarely issues both life insurance and any of these types of insurance. Therefore, we will limit our discussion to types (1), (2) and (3) *supra.*] See Washington Insurance Law, § 83(6), 84(3).

—each class with quite different definitions of "gross" and "net" income, and with different allowable deductions.

All three "Classes" of insurance companies wrote some *separate* "accident and health" insurance. Therefore, Congress had to determine whether a company which issued *both* (1) "life insurance" policies [whether with or without the incidental Disability Benefits], *and also* (2) *separate* "accident and health" insurance policies, belonged to

> Class I; to be taxed by the method peculiarly applicable to *life* insurance with its comparatively large interest-bearing reserve funds; *or belonged to*
>
> Class II, or Class III; to be taxed by quite different methods, better adapted to other forms of insurance.

Congress determined that question by specifically *defining* a "*life* insurance" company as follows:

> "§ 201(a) DEFINITION.—When used in this title the term '*life* insurance company' means an *insurance* company engaged in the business of issuing life insurance and annuity contracts (*including contracts of combined life, health, and accident insurance*), the *reserve funds* of which *held for the fulfillment of such contracts* comprise more than 50 per centum of its total reserve funds."

This meant that *whenever* any kind of an insurance company, which however issued *both,*

(1) Life insurance policies (whether with, or without, the incidental Disability Benefits); **and, also,**

(2) *Separate* "Accident and Health" insurance,

and also held "more than 50%" of its Reserves for group (1) contracts, it was to be treated, for purposes of taxation, as a *life* insurance company, to be taxed according to a formula which was peculiarly adapted to the comparatively larger interest-bearing [19] reserve funds of life insurance and disability insurance.

It also meant that, if such a company held "*more* than 50%" of its Reserves for group (2), *i. e., separate* "Accident and Health" insurance contracts, it would not belong to Class I [even though it was incorporated as a *life* company], *but* it must be treated as a Class II or Class III company, to be taxed according to a formula better adapted to smaller, and often non-interest bearing, Reserve funds.

When "an insurance company" holds these interest-bearing Reserves in a preponderant amount, it automatically becomes a "*life* insurance company" under § 201. The reserves held for the fulfillment of (*a*) Death Benefits in "*Non*-Disability" policies and (*b*) Death *and* Disability Benefits in "Disability" policies, are the type of interest-bearing Reserve funds, on account of which, Congress in 1921 devised the new formula for the taxation of *life* insurance companies on the basis of their income from interest, dividends and rents [Class I].

A striking illustration of the perfect working of the formula in § 201(a) is found in the *Monarch Life* cases, where, *first*, for 1932, Monarch Life was held to be a Class III company—[because the "reserve funds" for *separate* accident and health policies were "*more* than 50%" of its

[19] In all life insurance [whether providing for Death Benefits only, or for both Death and Disability Benefits combined], the risks increase with the policyholder's increasing age; and yet a *level* annual premium is charged. A large part of the premium received each year is therefore set aside (*i. e.* reserved)—producing large interest bearing "reserve funds" for both Death and Disability Benefits.

(*Continued on p. 37*)

"total reserve funds"];—while, *second*, for 1933 and 1934, the *same* company was held to be a Class I company, *i. e.*, a "*life* insurance company"—[because the reserve funds for its "Disability" and "*Non*-Disability" policies were "*more* than 50%" of its "total reserve funds"]. This complete change, between 1932 and 1933, arose, because, in 1933 it enormously increased its "Disability" and "*Non*-Disability" business, in comparison with the amount of its aggregate *separate* accident and health business (Cf. *Monarch Life Ins. Co.*, 38 B. T. A. 716, and Id. 801).

**IV. "Reserve funds" as used in § 201(a) includes the Reserve for Disability Benefits, as well as the Reserve for Death Benefits.**

This has been fully demonstrated above (pp. 28-31, *supra*).

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(*Continued from p. 36*)

On the other hand, the premiums received each year for *separate* "accident and health" insurance are ordinarily *exhausted* in covering the risks for that year. Therefore, in the case of *separate* "accident and health" insurance, reserve funds are ordinarily restricted to the comparatively small non-interest bearing "unearned premium" reserve funds [§ 204(b)(5)].

Congress taxed Class I differently from Classes II and III for the very purpose of making certain that any company which held a preponderant amount of "interest bearing" reserve funds, as contrasted with "non-interest bearing" reserve funds, would be taxed on that basis peculiarly adapted to a business inherently dependent upon its interest earnings.

## SECOND POINT.

[NATURE OF "TECHNICAL INSURANCE RESERVES"]

**1. In § 203(a)(2), the words "reserve funds required by law" refer to *technical insurance reserves; i. e.*, reserves held to meet a life insurance company's obligations which are entirely (a) future; (b) unaccrued; and (c) dependent upon life contingencies, or (d) dependent upon a series of life and disability contingencies.**

**2. For 1934, Oregon Mutual's $3,932,305.74 Reserve for "Disability" policies [including the disputed $250,861.09 Reserve for the Disability Benefits] was the *technical insurance reserve,* mathematically calculated as the then measure of its liability for the performance of only future, unaccrued, and contingent policy obligations [Death and Disability Benefits].**

§ 203(a) allowed a life insurance company the following deduction, *inter alia,* from its gross income:

> "(2) RESERVE FUNDS.—An amount equal to 4 per centum of the mean of the *reserve funds required by law* and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum."

It is an undisputed fact, found by the B. T. A. and conceded in the Government's Brief, that the $250,861.09 "reserve funds" in controversy here, are "*re-*

*quired by law"*—and, consequently, that phrase (controverted in some cases) is not involved here (C. C. A.'s Opinion 112 F. (2d) at p. 469, 64-65, 138-9; B. T. A.'s Finding R47; Government's Brief in C. C. A., pp. 22, 24, 25, 51; Oregon Insurance Code §§ 46-137; 46-503; pp. 7, 13, *supra*).

It is also an undisputed fact, found by the B. T. A. (R46); and established in all the cases (*Pan-American* case, 38 B. T. A. at p. 1434; *Monarch Life* case, 38 B. T. A. at p. 719; 114 F. (2d) at p. 319), that Oregon Mutual's $250,861.09 Disability Reserves were maintained out of the premiums, and from the interest earned thereon (R110, Table D).

We submit;

I. *"Reserve funds" in § 203 (a)(2) mean the technical insurance reserve; i. e., the* **"actuarially calculated"** *measure of a life insurance company's liability for the performance of its* **future, unaccrued, and contingent** *obligations for Death and Disability Benefits dependent upon* **life and disability contingencies.**

*Brief Summary of decided cases.* "Reserve funds" as used in § 203(a)(2) has a special "technical insurance meaning." [20]

1. On the one hand, *it does not include* liabilities of the following character [20a];

(1) Unpaid bills, taxes, salaries and brokerage. (*Maryland Cas. Co.* v. *U. S.*, 251 U. S. 342, 349.)

[20] *New York Life* v. *Edwards*, 271 U. S. 109, 120; *Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, 690; *Maryland Casualty Co.* v. *U. S.*, 251 U. S. 342, 350; *Continental Assur. Co.* v. *U. S.*, [Ct. Cl.] 8 F. Supp. 474, 478; *Old Line Ins. Co.*, 13 B. T. A. 758, 761; *Minn. Mutual* v. *U. S.*, 66 Ct. Cl. 481.

[20a] Cf. Regulations, No. 77, Art. 971, pp. 273-276 as amended by Treas. Dec. 4615 XIV-2 Cum. Bull. 312 Dec. 18, 1935; No. 86, Art. 203(a)(2), p. 298; No. 94, Art. 203(a)(2), p. 369; No. 101, p. 431; No. 103, p. 473 [1940].

(2) "Reserve for depreciation," "Reserve for taxes," "Reserve for bad or doubtful debts," "Reserve for losses on bonds, stocks or mortgages"—*none of which are peculiar to the business of life insurance.* (*Helvering* v. *Inter-Mountain Life,* 294 U. S. 686, 690.)

(3) *Accrued* but unpaid death losses, which are disputed or in process of payment or adjustment. (*Mass. Mutual* v. *U. S.,* 56 F. (2d) 897, 901; Cf. *McCoach* v. *Ins. Co. of N. Amer.,* 244 U. S. 585, 588, 589; *Maryland Cas. Co.* v. *U. S.,* 251 U. S. 342, 350, as modified by *U. S.* v. *Boston Ins. Co.,* 269 U. S. 197, 202-203.)

(4) Estimated death losses *accrued* December 31, but unreported. (*N. Y. Life* v. *Edwards,* 271 U. S. 109, 119).

(5) Estimated disability benefits *accrued* December 31, but unpaid. (*Mass. Mutual* v. *U. S.,* 56 F. (2d) 897, 898, 901; *Equitable Life Assur. Soc.,* 33 B. T. A. 708, 712.)

(6) Deferred dividends apportioned or awaiting apportionment. (*Minn. Mutual* v. *U. S.,* 66 Ct. Cl. 481.)

(7) Annual dividends apportioned, whether due and unpaid, or not yet due. (*Mass. Mutual* v. *U. S.,* 56 F. (2d) 897, 901.)

(8) Dividends left to accumulate at interest. (*Mass. Mutual* v. *U. S.,* 56 F. (2d) 897; *Midland Mutual,* 19 B. T. A. 765; *Equitable Life Assur. Soc.,* 33 B. T. A. 708, 716-717.)

(9) Premiums paid in advance. (*Midland Mutual Life,* 19 B. T. A. 765, 770; *Interstate Reserve Life,* 37 B. T. A. 54.)

(10) Mortality fluctuation fund. (*Old Line Ins. Co.,* 13 B. T. A. 758, 763.)

(11) Deposit of securities required by State Insurance Departments. (*Midland National Life,* 14 B. T. A. 200; *Kaskasia Life,* 22 B. T. A. 210; *Commonwealth Life,* 31 B. T. A. 887.)

(12) Deficiency reserves as required by New York Insurance Law §85. (*North American Reassur. Co.,* 29 B. T. A. 683.)

(13) Coupons (attached to policies) matured, unsurrendered, unpaid, and left to accumulate at interest. (*Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, 689-690; *Helvering* v. *Atlas Life*, 78 F. (2d) 166; *Helvering* v. *Missouri State Life*, 78 F. (2d) 778; *Continental Assur. Co.* v. *U. S.*, 8 F. Supp. 474, 479-483 I. T. 2717, Sept. 18, 1933.)

(14) Survivorship investment funds. (*Helvering* v. *Illinois Life*, 299 U. S. 88, 90-91; *Farmers Life*, 27 B. T. A. 423; Cf. *American Central Life*, 30 B. T. A. 1182.)

2. But, on the other hand, the term "reserve funds" [used in § 203(a)(2)] means the mathematically calculated amount, which (with future net premiums to be received and compound interest thereon) will be just exactly sufficient, at any given time, to meet all **"future, unaccrued and contingent"** Death and Disability claims under then outstanding policies, if such claims arise precisely as assumed in the Tables used in the calculation.[21]

The Commissioner of Internal Revenue concedes, and always has conceded, the correctness of the foregoing definition of "reserve funds" as used in § 203(a)(2), by providing in his Regulations No. 86, p. 298; No. 94, p. 369; No. 101, p. 431 and No. 103, p. 473 [January 29, 1940] as follows:

> "Art. 203(a) (2)—**Reserve Funds**—In general, the reserve contemplated is a sum of money, variously com-

[21] Regulations No. 77, Art. 971, p. 274; No. 86, Art. 203(a)(2), p. 298; No. 94, Art. 203(a)(2), p. 369; *Equitable Life Assur. Soc.*, 33 B. T. A. 708, 713-715; *Continental Assur. Co.* v. *U. S.*, 8 F. Supp. 474, 478, 482 (Ct. Cl.); *New World Life* v. *U. S.* (Ct. Cl. R53); *Old Line Ins. Co.*, 13 B. T. A. 758, 761-763; *Fink* v. *Northwestern Mutual Life*, 267 Fed. 968, 973 (C. C. A. 7th); *Standard Life Ins. Co.*, 13 B. T. A. 13, 26-31; *Mass. Mutual Life* v. *U. S.*, 56 F. (2d) 897; *New York Life Ins. Co.*, 24 B. T. A. 1217, 1229-1230; *Interstate Reserve Life Co.*, 37 B. T. A. 54; *Monarch Life Ins. Co.*, 38 B. T. A. 716-724, 726, S. C. 114 F. (2d) 314, 319, 320, 322, 323; *Pan-American Life Ins. Co.*, 38 B. T. A. 1430, 1435; S. C. 111 F. (2d) 366, 368; *Com'r* v. *Oregon Mutual Life*, 112 F. (2d) 468, 470; *Duffy* v. *Mutual Benefit Life*, 272 U. S. 613, 618; *Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, 690; *Rhine* v. *New York Life*, 248 App. Div. 120, 124; *Rubin* v. *Metropolitan Life*, 251 App. Div. 382.

> puted or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, **future unaccrued and contingent** claims."

In short, a "technical insurance Reserve" is the amount required to fulfill an insurance company's *executory* obligations for Death and Disability Benefits, **dependent upon life and successive disability contingencies**, as such obligations shall respectively fall due in the future. This is beyond dispute. It has never been even questioned. [See authorities cited in the margin; p. 41,[21] *supra.*]

In dealing with the New York Life's technical Reserve for Disability Policies, [which contained Death Benefits and Disability Benefits in one integral life insurance policy] the Appellate Division aptly said (*Rhine* v. *New York Life,* 248 App. Div., 120, 124; s. c. 273 N. Y. 1):

> "To offset the unavoidable increase in **death and disability** rates which arise from the yearly advance in age of members insured, the company must accumulate out of premiums a fund required by law to be held by every life insurance company, and known as 'Reserve'. The amount of reserve on any policy for any given age, plan, and time in force is a matter of mathematical calculation and is exactly the same when calculated by any actuary, depending on the particular mortality table, disability table and interest rate assumed."

Throughout that Opinion, the element of disability is treated always in the same phrase with interest, mortality and expense as constituting the essential elements in the Calculation of the Premium, the calculation and maintenance of the Reserve, the accumulation of Surplus, and its distribution as Dividends to the policyholders (See 248 App. Div. at pp. 123, 124, 125, 126, 127).

II. *Oregon Mutual's $3,932,305.74 Reserve for Disability policies [including the disputed* **$250,861.09** *Reserve for the Disability Benefits] was the technical insurance reserve, mathematically calculated as the then measure of its liability for the performance of only* **future, unaccrued** *and* **contingent** *policy obligations [Death and Disability Benefits].*

## I.

In 1934, Oregon Mutual had outstanding over 10,000 unmatured "Disability" policies, by each of which, Oregon Mutual had undertaken the following **future, unaccrued, and contingent obligations**, to-wit [R65; B. T. A. Findings of Facts R44-46; Opinion R47-49; Government's Brief in C. C. A. pp. 3-5, 23]:

**A. Death Benefits**— To pay a sum upon the *death* of the insured; *and also,*

**B. Disability Benefits**—To pay a specified sum to the insured, as *each successive* yearly date arrives, *provided* he is *alive* and *disabled at such date.*

Under those "Disability" policies, all held by *living* persons, Oregon Mutual's obligations [for the fulfillment of which the Reserve was $3,932,305.74] were entirely (*a*) *in the future;* (*b*) *unaccrued; and* (*c*) *contingent,* as follows:

**A. Death Benefits:**

[*a*] Under each of its "Disability" policies, Oregon Mutual had obligated itself to pay a definite sum upon the insured's death *in the future.*

On Dec. 31, 1934 none of these deaths had yet occurred. While some deaths would occur in the next year (1935),

and so on, others might not occur for many years to come, say 1970. On Dec. 31, 1934 the performance of the company's obligation lay wholly *in the future.*

[*b*] Since none of these deaths had occurred on Dec. 31, 1934 no payments had yet become due. Consequently, on Dec. 31, 1934, the whole of Oregon Mutual's obligation to pay such Death Benefits was still *unaccrued.*

[*c*] By the terms of these policies, no such payments were to be made by Oregon Mutual, *unless and until* the insured died. The maturity of the obligation was thus *contingent* upon the death of the insured—**a life contingency.**

There is no controversy over any Reserves for Death Benefits (whether in "Disability" or "*Non*-Disability" policies.

On the other hand, the entire controversy relates exclusively to Reserves for Disability Benefits. As will now be shown, these Reserves, precisely as Death Benefit Reserves, are solely held to meet Oregon Mutual's **future, unaccrued**, and **contingent** obligations—dependent here upon combined contingencies of death *and* disability.

**B. Disability Benefits:**

**Active** Lives: Oregon Mutual had obligated itself to pay a specified sum to the insured, as each successive yearly date arrives in the future, *provided* he is alive *and disabled at such date.* Yet, on Dec. 31, 1934 most of its 10,701 "Disability" policyholders, were "*active*", and had not suffered any disablement whatever. While some disablements might be fairly expected to occur in the next year (1935), others might not occur at all, or not for many years to come.

[*a*] Oregon Mutual's obligation for *Disability* Benefits as to these Active Lives, was thus *wholly executory;* its performance was **in the future**—as much so as its obligation to pay Death Benefits.

[*b*] Since none of these disablements had then [1934] occurred, no annual sums had then become due. Indeed, such sums might *never* have to be paid. Consequently, on Dec. 31, 1934 Oregon Mutual's entire obligation to provide Disability Benefits under those policies was still **unaccrued.**

[*c*] Furthermore, by the terms of these policies, Oregon Mutual was not bound to pay any such sums *unless the insured lived until he became disabled.* The maturity of Oregon Mutual's "disability" obligation was thus *contingent* upon the *continued* life of the insured—**a life contingency.**

But that is not all; for even if the insured should live until he became disabled, still Oregon Mutual was not bound to pay, unless, *after* his disablement, the insured *continued to live* until the first yearly date arrived; nor was it bound to pay any further sums, *unless* the insured should *further continue to live* until the successive yearly dates thereafter arrived, and be disabled at each such date.

In other words, in case of every "Disability" policy, Oregon Mutual's "disability" obligation was *contingent* upon the insured's (1) *living* until disablement, and (2), and equally important, upon his *continuing to live thereafter* until the successive yearly dates arrived—**a life contingency and also a series of disability contingencies,**[22]—for the fulfillment of which obligations, Oregon Mutual held "as required by law" its $111,127.58 Active Life Reserve in controversy (pp. 14, *supra,* 48, *infra*).

[22] *Equitable Life Ass. Soc.,* 33 B. T. A. 708, 710-711; *Com'r* v. *Oregon Mutual Life,* 112 F. (2d) 468, 470 (C. C. A. 9th); *Com'r* v. *Pan-American Life,* 111 F. (2d) 366, 368 (C. C. A. 5th); *Com'r* v. *Monarch Life,* 114 F. (2d) 314, 319, 320 (C. C. A. 1st).

**Disabled** Lives: A small *remainder* of its 10,701 "Disability" policyholders had, from time to time theretofore, become disabled, and were still *disabled* on Dec. 31, 1934.

As to them, Oregon Mutual had obligated itself to pay the specified sum to each disabled insured as each successive yearly date should **arrive in the future**, *but, provided always*, such insured (*a*) should *not only* **survive in the future** to the successive yearly dates on which such sums should become due, but (*b*) should continue **still to be disabled** on such future dates.

On Dec. 31, 1934 none of these dates had yet arrived. Some disabled policyholders might reasonably be expected to survive until the required dates in the next year (1935), in the next year (1936), and so on. Others would not even survive until the required date in 1935. Still others would drop out by death, from year to year, for many years to come.

[*a*] Whether or not any specific payment, or any other of such payments, would ever have to be made, depended upon,

(*a*) Whether the insured survived *in the future* to the date [some to dates in 1935 and others to dates in year to year thereafter, for many years in the future] on which such payments fell due; and

(*b*) Whether the insured should, **at such future date**, still be disabled.

On Dec. 31, 1934, none of these insured had then survived to the requisite *future* yearly dates, and no payments had then become due. The obligation was **in the future.**

[*b*] Consequently, on Dec. 31, 1934 under each of these "Disability" policies, Oregon Mutual's obligation to pay any sums (even to an insured *already* disabled) was still **unaccrued.**

[*c*] By these policies, Oregon Mutual was not obligated to pay any sum, *unless and until* the insured (already disabled) (*a*) **further survived** to the requisite successive future yearly dates, **and** (*b*) **was still disabled** on each of such future dates.

The maturity of the obligation was thus dependent upon —**a life contingency, and also a series of disability contingencies** (*Equitable Life Assur. Soc.*, 33 B. T. A. 708 at 711-716 *re* the 90% item; see note [22] p. 45, *supra*) for the fulfillment of which obligations Oregon Mutual held "as required by law" the $139,733.51 Disabled Life Reserve in controversy (pp. 2, 13, 14, 30, *supra;* p. 48, *infra*).

The amount of these **future, unaccrued and contingent** liabilities can be computed only by actuarial calculations (Oregon Mutual R67-112).

• • • • • • • •

Neither the foregoing discussion, nor any of Oregon Mutual's Reserves, relate in the slightest degree (*a*) to any Death Benefit where the insured *had died* on, or before, Dec. 31, 1934, nor (*b*) to any Disability Benefits where the yearly date had *already arrived* for the insured to receive such Disability Benefit (*Equitable Life Assur. Soc.*, 33 B. T. A. 708, at 712, 716 *re* the 10% item, p. 76 note [38], *infra*).

On the contrary, the foregoing discussion as to Disability Benefits relates solely and exclusively (1) to over 10,000 policies held, on Dec. 31, 1934, by *living* policyholders; and (2) to Disability Benefits to which the insured would not be entitled, under any circumstances whatsoever, until some **future date** *after* Dec. 31, 1934; and only *then*, conditioned upon such insured's (*a*) having **further survived**, and (*b*) having **continued disabled**, until such future date.

With respect, therefore, to its entire 10,701 "Disability" policies outstanding on Dec. 31, 1934 the whole of Oregon Mutual's obligations for Disability Benefits were **in the**

**future**; were **unaccrued**; and were **contingent** upon the **continued life** and **disability** of the policyholders.

This shows that its Disability Reserves (for both Active and Disabled Lives)—precisely as Death Benefit Reserves—are required by law to be held to enable Oregon Mutual certainly to fulfill its **future unaccrued and contingent** [Death *and* Disability] obligations for Disability Benefits.

## II.

In 1934 [when calculated by the universally used, and admittedly correct, processes of pure mathematics R93-112; pp. 41-42 note [21], *supra*, and authorities cited therein], Oregon Mutual's Reserve [for its "Disability" policies] was (pp. 11, 13-15, 30, *supra*) $3,932,305.74:

Subdivided as follows:

1934 Reserve for "Disability" Policies

| | | | |
|---|---|---|---|
| For Death Benefits | | $3,681,444.65 | |
| For Disability Benefits | Active Lives $111,127.58 | | |
| | Disabled Lives 139,733.51 | 250,861.09 | $3,932,305.74 |

| | Reserve | | Deduction | Asserted Tax Deficiency at 13¼% |
|---|---|---|---|---|
| Of which | $3,932,305.74: | | | |
| Com'r *allowed* a 3¼% deduction on Death Benefit Reserve of | $3,681,444.65 | or | $138,054.17 | |
| Com'r *disallowed* a 3¼% deduction on Disability Benefit Reserve of | 250,861.09 | or | $9,407.29 | $1,293.50 |
| Oregon Mutual *claimed* a 3¼% deduction on its "Disability" policies' total Reserve of | $3,932,305.74 | | | |

The Commissioner was clearly wrong in *disallowing* the 3¾% deduction on the **$250,861.09** Disability Reserve.

Our apology for the repetition of these figures (pp. 2, 11-13, 30, *supra*) is simply that they show here, at a glance, that the **$250,861.09** Reserve in controversy was a part of Oregon Mutual's $3,932,305.74 total technical insurance Reserve [23] which *was* (and any *lesser* amount would *not* be) the exact mathematically calculated measure of Oregon Mutual's liability on December 31, 1934 for its **future, unaccrued and contingent** obligations to its then *living* 10,701 policyholders for their *future* Death and Disability Benefits, **none of which obligations or benefits had then become payable through either the Death, Disablement, or continued Disability, of a policyholder (R65, 126, 130-132).**

No further argument is necessary.

## III.

Of Oregon Mutual's $3,932,305.74 Reserve on "Disability" policies on Dec. 31, 1934, the Commissioner properly allowed $3,681,444.65 *Death* Benefit Reserve; but he wrongfully *disallowed* $250,861.09 [24] *Disability* Benefit Reserve [part of the $3,932,305.74]. He was clearly wrong in such disallowance. The B. T. A. and C. C. A. corrected his error.

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[23] That Reserve does not measure, nor take into account, any liability whatsoever of Oregon Mutual (1) to pay any Death Claim on account of any policyholder who had *died*, or (2) to waive any *past due premium*, or (3) to pay *any past due* sum on account of any policyholder's *disability*.

[24] The Commissioner's *disallowance* of $250,861.09 Disability Reserve is the sole cause of the 1934 disputed tax liability of $1,293.50.

## THIRD POINT.

[INTERPRETATION OF § 203(a)(2)]

**In § 203(a)(2), the phrase "reserve funds" is not restricted to Reserve for Death Benefits only [as the Commissioner contends]; but it also includes the $250,861.09 Oregon Mutual's Active and Disabled Life Reserve for the Disability Benefits [contained in the 10,000-odd "Disability" policies], which $250,861.09 the Commissioner erroneously disallowed when calculating the 3¾% deduction.**

§ 203(a)(2) provided that Oregon Mutual might *deduct* from its "gross" income,

> (2) RESERVE FUNDS—An amount equal to 4 per centum of **the mean of the reserve funds required by law** and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum.

### I.

We have shown,—the B. T. A. and C. C. A. have found,—and the Government conceded—that the **$250,861.09** Active and Disabled Life Reserve for Disability Benefits,—alone in controversy here,—is, "required by law" (pp. 13, 39, *supra;* R47; 112 F. (2d) at p. 469).

It is included in Oregon Mutual's $3,932,305.74 Reserve, which is held for the fulfillment of Oregon Mutual's **future, unaccrued and contingent** obligations dependent upon life and disability contingencies; and is a *technical*

*insurance reserve* within the meaning of §§ 201(a), 203(a)(2) [pp. 39, 41-43, 48, 58, *supra*].

## II.

The only remaining dispute is whether "reserve funds" used in § 203(a)(2), is *limited* to the reserve for *Death* Benefits only, or includes, *inter alia,* Reserve for both Death Benefits *and Disability Benefits* where "required by law" under "contracts of *combined* life, health and accident insurance" *i. e.,* "Disability" policies (R45-47; Government's Brief in C. C. A., pp. 3, 5, 24-25, 27, 28, 31).

In *Continental Assur. Co.* v. *U. S.,* 8 F. Supp. 474, [1934] the Court of Claims (LITTLETON, J.) clearly and forcefully showed that "reserve funds" as used in § 203(a)(2) *is not restricted* to Reserves for *Death* Benefits only; but that it also includes *all technical insurance reserves* held by a life insurance company to meet its **future, unaccrued and contingent** obligations for every kind of business [conducted by a "life insurance company" as defined in § 201(a)]—even though it be "reserve funds" for a type of insurance business, **such as fire or marine insurance**, not usually written by a life insurance company.

The Court of Claims there reviewed many cases; and it analyzed and clearly stated the true meaning of "reserves required by law" saying (8 F. Supp. 478):

> "In the case of life-insurance companies, the computation of the reserve, in connection with which the deduction is allowable, is to be made upon the basis of an experience table of mortality and an assumed rate of interest, the calculation of which is an actuarial function, **and the reserve intended by the taxing act as a deduction is the amount set aside from premiums and built up by interest accretions to meet existing unmatured insurance, whether fire, marine, or life insurance.**"

In the *Monarch Life* case, C. C. A. (1st) reached the same conclusion saying (114 F. (2d) at p. 323):

> "Once a company has been found to be a life insurance company under this definition [definition of § 201(a)], the type of its policies is no longer important; all its business is treated as though it were life insurance".

In support of that obviously correct determination by the Court of Claims in 1934,[25] and by C. C. A. (1st) in 1940, we further submit:

I. *No limiting words:* In § 203(a)(2), there are no limiting words to restrict the all embracing phrase "reserve funds" to any particular *type* of policy or *form* of benefit. If Congress had intended to restrict "reserve funds" to certain classes of policies or of benefits, it could easily have said so.

In the *Oregon Mutual* case, the C. C. A. (9th) aptly said (112 F. (2d) at p. 470):

> "Since the words 'reserve funds,' as used in the classification statute [§ 201(a)], embrace disability reserves held against combined life and disability policies, we see no persuasive reason to believe that they should be held to mean less than that when used in § 203(a)(2). Had Congress intended a narrower application of the term for the purpose of the deduction, **presumably it would have said so in apt language.**"

Similarly, with respect to § 203(a)(2), the C. C. A. (1st) said in the *Monarch Life* case (114 F. (2d) at p. 325):

> "If Congress had intended to limit the reserve deduction to *life* reserves **it could easily have said so.**

[25] Five years later, the Court of Claims (again LITTLETON, J.) *unconsciously* departed from that ruling in its more recent opinion in *New World Life* v. *U. S.*, 26 F. Supp. 444, 463-4 (1939) [See pp. 4, 17-24, *supra* for a critique of the *New World* case].

> In the absence of explicit language, the general meaning of the words as previously construed to apply to other than life reserves should be accepted. (*Com'r* v. *Oregon Mutual Life Ins. Co.*, 112 F. (2d) at page 470)"

The entire lack of any limitation upon the nature of the "reserve funds" [with respect to which 3¾% deduction was allowed] is quite conclusive that the words "reserve funds" cover *all* of a life insurance company's *technical insurance reserves.* "Reserve funds" must, therefore, be construed to include Reserve for *Disability* Benefits, as well as Reserve for *Death* Benefits.

2. *No differentiating words:* In the absence of any differentiation between the meaning of "reserve funds", in § 201(a), and in § 203(a)(2), Congress must have attributed **the same meaning** to those *identic words* when used in two almost successive sections. In *Pan-American Life Ins. Co.*, 38 B. T. A. 1430, 1440, the B. T. A., first, pointed out that the term "reserve funds" in § 201(a) unquestionably applied to "Disability" policies, and, then, aptly added:

> "Therefore, it would seem to follow that the term 'reserve funds' in section 203(a)(2) would also apply to 'contracts of combined life, health, and accident insurance,' which is the type of policies involved in the instant proceeding."—*i. e.*, Reserve for Disability Benefits in "Disability" policies.

*Even the Court of Claims reached the same conclusion.* In the case at bar (*New World Life* v. *U. S.*, 26 F. Supp. 444) the Court of Claims held that "reserve funds" in § 201(a) *meant exactly the same thing as* "reserve funds" in § 203(a)(2), saying (p. 463; New World R52),

> "we are of opinion that Congress used the term 'reserve funds' in section 203(a)(2) **in the same sense** in which it was used in section 201(a) just considered."

This is precisely correct. However, the Court of Claims completely *misconstrued* § 201(a); and consequently it gave the *same misconstruction* to § 203(a)(2). [See p. 24, *supra.*]

3. Since § 203(a)(2) permits a deduction based on reserves *"not required by law"* it would seem reasonable that the *same section* meant to allow a deduction, based on the same kind of reserves *"required by law"*.

The latter part of § 203(a)(2) provides for a different deduction, *i. e.* based on reserves *"not* required by law," to-wit:

> "(2) RESERVE FUNDS.—An amount . . . plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 3¾ per centum of the mean of such reserve funds **(not required by law)** held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of holders of such policies only;"

It is inconceivable that Congress, in enacting the 1921 and subsequent Revenue Acts, could have intended to permit some companies to take a deduction of 3¾% of certain reserves **not required by law** held for the fulfillment of a particular kind of *combined* life, health, and accident policy, and at the same time prohibit other companies from taking a 3¾% deduction of a part of the reserve specifically **required by law**, held for the fulfillment of their contracts of *"combined* life, health, and accident insurance," *i. e.*, the Disability Reserve.

Referring to this point, in the *Oregon Mutual* case C. C. A. (9th), said (112 F. (2d) at p. 470):

> "The words 'reserve funds required by law', used in the latter section, unquestionably refer to technical insurance reserves. But we think, as in § 201 (a), they comprehend reserves held to meet a life

> insurance company's obligations dependent either upon life contingencies or upon life and disability contingencies. **The provision contained in the last sentence of § 203(a)(2) tends strongly to support this view."**

Similarly, in the *Pan-American* case, C. C. A. 5th, said (111 F. (2d) at p. 368):

> "A further inconsistency in the position we are urged to take is evidenced by the provisions of Section 203(a)(2) of the Revenue Act of 1932, which expressly permits percentage deductions upon casualty reserves held by life insurance companies on certain types of policies, even though **not required by law.** It is unreasonable to believe that Congress would discriminate between companies doing the same kind of casualty business, as the interpretation would require, when the conclusion we have reached is entirely in harmony with the theory of equal benefits. Our conclusion is that the reserve for incurred disability benefits held by the taxpayer was a fund required by law within the meaning of the statute."

4. *Bureau of Internal Revenue's fourteen years' Administrative construction:* For nineteen years [1921-1939], eight successive Revenue Acts, *in identic language,*[26] authorized life insurance companies to deduct 4% [or 3¾%]

> "of the mean of the reserve funds required by law".

For fourteen years [1921-1935], the Commissioner's Regulations,[27] with respect to that deduction, expressly provided that

> "Generally speaking, the following will be considered **reserves as contemplated by the law:** Items 7-11 of

[26] § 245(a)(2) [1921, 42 Stat. 261; 1924, 43 Stat. 289; 1926, 44 Stat. 47] § 203(a)(2) [1928, 45 Stat. 843; 1932, 47 Stat. 224; 1934, 48 Stat. 732; 1936, 49 Stat. 1711; 1938, 52 Stat. 523; 1939, 53 Stat. 865].

[27] Art. 681, Regulations Nos. 62, 65, 69; Art. 971, Regulations Nos. 74, 77.

the liability page of the annual statement for life insurance companies."

Items 8 and 9 of such "annual statements" read:

| Disability Reserves | |
|---|---|
| [Active Life] | "8. Extra reserve for total and permanent disability benefits . . . included in life policies . . . $_____" |
| [Disabled Life] | "9. Present value of amounts incurred but not yet due for total and permanent disability benefits . . . $_____" |

Accordingly, for twelve years [1921-1932] the Commissioner allowed Oregon Mutual, as well as all other life insurance companies, the 4% [or 3¾%] statutory deduction for the Active Life Reserve [Line 8]; and for Disabled Life Reserve [Line 9].

See *Pan-American Life Insurance Company,* 38 B. T. A. at pp. 1436-7 for a very satisfactory discussion of this point; affirmed in *Com'r* v. *Pan-American Life,* 111 F. (2d) 366 at p. 367 (C. C. A. 5th).

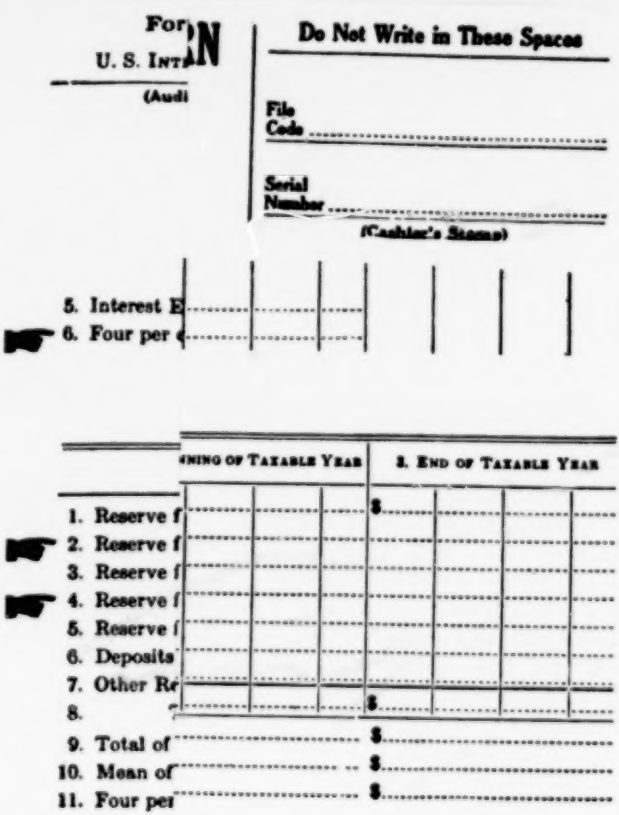
5. *Form of Income Tax Return.* During 1921-1934, U. S. Internal Revenue Form 1120L headed

> "LIFE INSURANCE COMPANY INCOME TAX RETURN for companies issuing life and annuity contracts including combined life, health and accident insurance."

expressly included "Reserve for *Disability Benefits*" as a part of

> "reserve funds required by law"

in "Schedule A—Reserve Funds" of which 4% should be deducted as follows: [Cf. Lines, 2, 4, 10, 11; "Deductions" Line 6].



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Do Not Write in These Spaces

File Code .....

Serial Number .....

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5. Interest E.....
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| | [illegible]NING OF TAXABLE YEAR | | | 2. END OF TAXABLE YEAR | | | |
|---|---|---|---|---|---|---|---|
| 1. Reserve f..... | | | | $ | | | |
| 2. Reserve f..... | | | | | | | |
| 3. Reserve f..... | | | | | | | |
| 4. Reserve f..... | | | | | | | |
| 5. Reserve f..... | | | | | | | |
| 6. Deposits..... | | | | | | | |
| 7. Other Re..... | | | | | | | |
| 8. ..... | | | | $ | | | |
| 9. Total of..... | | | | $ | | | |
| 10. Mean of..... | | | | $ | | | |
| 11. Four per..... | | | | $ | | | |

In 1936, [with no change in the law which has now stood unamended [28] for nineteen years], the Commissioner disallowed all of Oregon Mutual's **$250,861.09** Active and Disabled Life Reserves for Disability Benefits, resulting in the proposed $1,293.50 tax deficiency for 1934 (R26, 41-45). The Commissioner thereby reversed himself, and departed from his own long established Regulations, and from his previously uniform administrative construction of § 203(a)(2).

[28] So far as material here.

See *Pan-American Life Insurance Company,* 38 B. T. A. at pp. 1437-8 for a discussion of the Commissioner's sudden change in his construction of § 203(a)(2); followed in *Monarch Life* case 114 F. (2d) 314 at page 323 (C. C. A., 1st); *Pan-American Life* case 111 F. (2d) 366 at pages 367-8 (C. C. A. 5th); *Oregon Mutual Life* case 112 F. (2d) 468, at 471 (C. C. A. 9th).

This very "reserve fund" deduction was the subject of long consideration and mutual discussion between Congressional Committees and the insurance companies.[29] For fifteen years, the Regulations, the Commissioner's construction of § 203(a)(2), the Income Tax blanks and the uniform administrative practice thereunder were all known to and acquiesced in by Congress, as it *re-enacted* § 203(a)(2) [formerly § 245(a)(2)] *six times without alteration.* The long established construction of the technical words "reserve funds required by law" **as including both Active Life and Disabled Life Reserves,** and the administrative practice to the same effect, should not now be overturned.[30]

6. *"Disability" Policies—a single integral insurance contract.* In excluding Oregon Mutual's $250,861.09 Disability Reserves from "reserve funds" [§ 203(a)(2)], the Commissioner denies Oregon Mutual a deduction based on a Reserve of the very kind, which, because held in sufficient amount, is the only thing which makes Oregon Mutual tax-

[29] See *National Life* v. *U. S.,* 277 U. S., at p. 523, note; *Helvering* v. *Independent Life,* 292 U. S. at p. 379; Government's Brief in *Oregon Mutual* case at pp. 10-13.

[30] *Helvering* v. *R. J. Reynolds Tobacco Co.,* 306 U. S. 110, 114-115; *Mass. Mutual Life* v. *U. S.,* 288 U. S. 269, 273; *U. S.* v. *Jackson,* 280 U. S. 183, 193, 196; *Lucas* v. *American Code Co.,* Id. 445, 449; *Universal Battery Co.* v. *U. S.,* 281 U. S. 580, 583; *Fawcus Machine Co.* v. *U. S.,* 282 U. S. 375, 378; *Norwegian Nitrogen Co.* v. *U. S.,* 288 U. S. 294, 313, 315; *Alaska S.S. Co.* v. *U. S.,* 290 U. S. 256, 262; *Koshland* v. *Helvering,* 298 U. S. 441, 445; *Continental Assur. Co.* v. *U. S.,* 8 F. (Supp.) 474, 483; *Helvering* v. *Winmill,* 305 U. S. 79, 82-83.

able as a *life* insurance company. § 201(a) says that if the Reserve for the Disability Benefits contained in "Disability" policies, *plus* the Reserve for Death Benefits contained in both "Disability" and "*Non*-Disability" policies, comprise more than 50% of a company's Total Reserve funds, then that makes the company taxable as a *life* insurance company. It is inconceivable that Congress intended § 203(a)(2) to limit a company's Reserve deduction (peculiar to life insurance) to only a part of the same reserves which, because held in sufficient amount, made that company a life insurance company for tax purposes (*Oregon Mutual* case, 112 F. (2d) 468, 470 [C. C. A. 9th]).

The Commissioner improperly reaches a contrary conclusion by doing the very thing which the Courts have uniformly decided must not be done, viz., it treats a "Disability" policy of "*combined* life, health and accident insurance", *as if* there were two separate, complete, and independent contracts of insurance, to-wit:

(1) A contract of life insurance, *and also,*

(2) A contract of disability insurance;

and it deals with each, as though *the other* were non-existent.

That same argument for the *supposed* existence of two *separate* contracts of insurance has been often made and uniformly rejected (See cases collated in the margin [31]; and a full review of the leading cases at pp. 20-24, 32-34, *supra*).

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[31] *Steinberg* v. *New York Life,* 263 N. Y. 45, 1933; *Ginnell* v. *Prudential,* 205 App. Div. 495; s. c. 237 N. Y. 554; *Halperin* v. *Equitable Life,* 125 Misc. 422; *Ursaner* v. *Metropolitan,* 146 Misc. 121; *Chambers* v. *New York Life,* 148 Misc. 561; *Berg* v. *Equitable Life,* 149 Misc. 856; *Finklestein* v. *Metropolitan,* 151 Misc. 113; *Lubow* v. *Prudential,* 152 Misc. 62; *Garms* v. *Travelers,* 242 App. Div. 230; s. c. 266 N. Y. 446; *Heilbronn* v. *New York Life,* 243 App. Div. 558; *Donahue* v. *New York Life,* 259 N. Y. 98, 104; *Wittman* v. *Littlefield,* 142 Misc. 916 (Aff'd 235 App. Div. 831); *Purcell* v. *Washington Fidelity Ins. Co.* (1932) 141 Ore. 296; *Prudential Ins. Co.* v. *Litzke*

(Continued on p. 60)

The provision for Disability Benefits is only one out of various provisions in Oregon Mutual's policies (R155-7), the Reserve for which has been calculated *in solido* for the policy as a whole.[32]

By reason of the inherent nature of a "Disability" policy as a **single integral insurance contract**, with a Reserve calculated and held *in solido* for the policy as a whole, of which there can be no separation, it is impossible that Congress, in using the words "reserve funds" in § 203(a)(2), meant arbitrarily (without saying so) to split up the "reserve funds"—allowing a deduction with respect to one type of benefit [Death], and denying a deduction as to the other type of benefit [Disability].

7. The Commissioner's construction of the phrase "reserve funds" in § 203(a)(2) is absolutely **self-contradictory**:

Here, the Commissioner contends that the phrase *must be restricted* to Reserves for *Death* Benefits only; *whereas*, the Commissioner's Income Tax Return Forms expressly provide for the § 203(a)(2) deduction on "Reserve for **Annuities**"—contracts which provide *no* Death Benefits

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(*Continued from p. 59*)

(1934) 36 Del. 592, 179 Atl. 492; *Paulson* v. *Montana Life Ins. Co.*, 181 Wash. 526, 43 Pac. (2d) 971; *Baranovich* v. *Horwatt*, 113 Pa. Sup. Ct. 467, 173 Atl. 676; *Smith* v. *New York Life*,—N. C.—; *Provident Life & Acc. Co.* v. *Rimmer*, 157 Tenn. 597; *Lamar Ins. Co.* v. *Culp*, 168 Tenn. 332; *Levin* v. *Scranton Life*, 304 Pa. 92; *New York Life* v. *Doerksen*, 64 F. (2d) 240; *Smith* v. *Equitable*, 89 S. W. (2d) 165 (Tenn.); *Guardian Life* v. *Barry*, 6 N. E. (2d) 725 (Ind.).

See also: *Buffo* v. *Metropolitan*, 277 Ill. App. 366; *Grenon* v. *Metropolitan*, 161 Atl. 229 (R. I.); *Gerson* v. *Metropolitan*, 187 Atl. 194 (N. J.); *Julius* v. *Metropolitan*, 299 Ill. 343; *Henricks* v. *Metropolitan*, 61 Pac. (2d) 1162; *Richards* v. *Metropolitan*, 55 Pac. (2d) 1067.

[32] For accounting purposes, and in order to facilitate an analysis of a company's standing, the Insurance Commissioner's "Convention" blank requires that the company shall show the Reserve separately for (i) Death Benefits on all policies and (ii) Disability Benefits (sub-classified for Active and Disabled Lives)—but such classification is merely shown for statistical reasons.

whatever.[33] An annuity contract is not a life insurance contract; in fact, it is essentially the *reverse* of a life insurance contract.[34]

The Commissioner has never questioned a company's right to include **Annuity** Reserves in "reserve funds" as used in § 203(a)(2)—obviously because § 201(a) expressly provides for "reserve funds . . . held for . . . life insurance and *annuity* contracts". § 203(a)(2) refers to the *same* "reserve funds".

It is too plain for further argument that [when the Commissioner admits in his Income Tax Forms that, in § 203(a)(2), the phrase "reserve funds" include Reserves for **Annuities** (which provide *no* Death Benefits)], he cannot (merely to tax Oregon Mutual) properly contend that the *same identic phrase* in the *same identic* section, shall, in the case of the Oregon Mutual, be *suddenly restricted* to Reserve for *Death Benefits* only.

8. From 1921 to 1935, the Commissioner's Regulations and administrative practice specifically provided that "reserve funds" in § 203(a)(2) included Reserve for *all Disability* Benefits (as well as Reserve for *Death* Benefits).

On February 11, 1935, the Commissioner promulgated Regulations No. 86, which the Government now cites as its authority for *restricting* "reserve funds" to Reserve for *Death* Benefits only.

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[33] Form 1120L; IV C. C. H. 1934, p. 19203, p. 48, *supra*.

R30-4% deduction on account of American Annuitant 4% "Reserve for . . . Annuities"; Item 5 in Exhibit A, and in Exhibit B, R178, 180; Regulations No. 77, Art. 971, p. 274; No. 86, p. 298; Washington Ins. Laws §§ 83(3), 92.

[34] *Hall* v. *Metropolitan*, 146 Or. 32; *Carroll* v. *Equitable*, 9 F. Supp. 223, 224; *Cannon* v. *Nicholas*, 80 F. (2d) 934; *Commonwealth* v. *Metropolitan*, 254 Pa. 510; *Metropolitan* v. *Knapp*, 198 App. Div. 413, 415, s. c. 231 N. Y. 630; *Moskowitz* v. *Davis*, 68 F. (2d) 818; *Rishel* v. *Pac. Mut.*, 78 F. (2d) 881; *In re Thornton's Estate*, 186 Minn. 351; *State* v. *Equitable Life* (N. D.), 282 N. W. 411; *Wellman* v. *The Board of Tax Commissioners*, 252 Pac. 193; *Brownstein* v. *New York Life*, 158 Md. 51; *Cahill* v. *Maryland Life*, 90 Md. 333; *Smith* v. *Mutual Life*, 158 F. 365.

However, even Regulations 86 (like the subsequent Regulations 94, 101 and 103) do not support the Commissioner's present construction of "reserve funds". Regulations 86 (p. 298) provide that the phrase "reserve funds"

> "does not include . . . estimated value of *future premiums* which have been *waived* on policies *after* proof of total and permanent disability".

This Regulation only attempts to exclude (from "reserve funds") (i) the *Disabled* Life Reserve; and (ii) that *only* with respect to the relatively unimportant Waiver of Premium Benefit.

Regulations 86 do not attempt to exclude, directly or indirectly, (1) any *Active* Life Reserves for both Waiver of Premium and Income Benefit [$111,127.58, Table II, p. 13, *supra*], or (2) *Disabled* Life Reserves for the relatively very important Disability *Income* Benefit [principal part of $139,733.51, Table II, p. 13, *supra*].

The Commissioner's present contention that "reserve funds", as used in § 203(a)(2), are *restricted* to the Reserve for *Death* Benefits only, is thus entirely *inconsistent* with his own Regulations 86. Regulations 86 do *not* restrict "reserve funds" to Reserve for *Death* Benefits only. This is so, because they *permit the deduction* in respect to both (1) all *Active* Life *Disability* Reserves, and (2) all *Disabled* Life *Disability* Reserves for the Disability *Income* Benefit. The Disability Benefits, for which these Reserves are held, in no way involve any Death Benefits.

9. The legislative history of the 1921 Revenue Act shows that the phrase "reserve funds" in § 203(a)(2)—never changed since—was not intended to be restricted to reserves for *Death* benefits only; but, in fact, was intended to embrace *all* technical insurance reserves.

As passed by the House, the 1921 Revenue Act provided that all kinds of insurance companies should have a 4%

deduction of "reserve funds required by law", thus including every kind of technical insurance reserve (as already defined in *McCoach* v. *Ins. Co.*, 244 U. S. 585, 589; *Maryland Cas. Co.* v. *U. S.*, 251 U. S. 342), whether relating to death, accident, disability, fire, marine, plate glass, etc. As finally passed, Congress limited that deduction to *life* insurance companies only, as defined in the Act. Since the language *was not changed* from that originally applicable to *all kinds* of insurance, the phrase "reserve funds" must be construed to embrace *every kind of technical insurance reserve,* provided only it is held by a *life* insurance company. This is so, because the meaning of words, designedly including *every form* of technical insurance reserve, does not change when it is restricted to *one kind* of insurance company.

## III. Review of Authorities.

Since 1921, every life insurance company has been permitted to deduct 4% of its "reserve funds required by law" (pp. 3, 55-56, *supra*).

From time to time, the Board of Tax Appeals, Court of Claims, and this Court have disallowed particular deductions upon the ground that they were based on some special reserve fund, which was not a "reserve fund" within the meaning of § 203(a)(2).[35] In so doing, those Courts have drawn a clear line of demarcation between "deductible" and "non-deductible" reserve funds [See the cases summarized in pp. 39-41, *supra*].

In those cases, the Courts have precisely defined "reserve funds", as used in § 203(a)(2), to mean the mathematically calculated sum (1) directly pertaining to insurance risks, and (2) necessary to meet the company's future, unaccrued, and contingent obligations, which are

[35] § 245(a)(2) in earlier Acts [see p. 2, note [2]; p. 55 note [26], *supra*].

dependent upon **life and disability contingencies.** (See pp. 41 note [21], 42-48, *supra*, and cases there cited.)

To narrow that definition now so as to exclude *Disability* Reserves would emasculate and wreck the uniform construction and administration of every Revenue Act since 1909.

• • • • • • • • • • •

In the several B. T. A. and C. C. A. (1st, 5th and 9th) cases now to be reviewed, the Courts have carefully pointed out the *exact equivalence* in the character of the Reserves, although called by different names. The following Table shows such equivalence—in terms of Active Life Reserves and Disabled Life Reserves, which are the terms used by New World:

| | Nature of Policies and Reserves | | | |
|---|---|---|---|---|
| Company | "*Separate* accident and health" | | "*Combined* life, health and accident insurance" [§ 201(a)] | |
| | **Active Life** | **Disabled Life** | **Active Life** | **Disabled Li** |
| Equitable [33 B. T. A. 708] | "Additional reserve on non-cancellable accident and health policies" (p. 710) | "Reserve for unpaid and unresisted claims" (pp. 711, 716) | None | None |
| Monarch [38 B. T. A. 716] 114 F. (2d) 314 | "Additional reserve on non-cancellable accident and health policies" (pp. 720, 724; 321) | "Reserve for unpaid and unresisted claims" (pp. 721, 724; 322) | None | "Reserve for curred disab benefits" (pp. 718, 72 320) |
| Pan-American [38 B. T. A. 1430] 111 F. (2d) 366 | None | None | | "Reserve for curred disab benefits" (pp. 143 1436-9, 36 |
| Oregon Mutual [39 B. T. A. 1239] 112 F. (2d) 468 | None | None | "Active Life Reserves" (112 F. (2d) 469 | "Disabled L Reserve (112 F. (2d |
| New World [26 F. Supp. 444] | None | None | "Active Life Reserves" (R47) | "Disabled L Reserves (R47) |

***Oregon Mutual Life Insurance Co., 39 B. T. A. 1239; 112 F. (2d) 468* [*C. C. A. 9th*].**

In 1934, Oregon Mutual had over 10,000 "Disability" policies, with Reserves as follows:

| | | | | Reserve |
|---|---|---|---|---|
| 1934 Disability Policies | Death Benefits | | | $3,681,444.65 |
| | Disability Benefits | Active Lives | $111,127.58 | |
| | | Disabled Lives | 139,733.51 | 250,861.09 |
| | | | Total Reserve | $3,932,305.74 |

The controversy arose as follows:

1934 "DISABILITY" POLICIES

| | |
|---|---|
| Oregon Mutual contended "Reserve Funds" were... | $3,932,305.74 |
| Com'r contended "Reserve Funds" were for *Death* Benefits only ..... | 3,681,444.65 |
| Com'r excluded Reserve for *Disability* Benefits..... | $ 250,861.09 |
| Com'r disallowed deduction of 3¼% [§ 203(a)(2)] | $ 9,407.29 |
| Com'r asserted tax deficiency of 13¼% of $9,407.29 | $ 1,293.50 |

B. T. A. held that the Commissioner was wrong; that Oregon Mutual was right; and that "reserve funds" in § 203(a)(2) included all the technical reserve on "Disability" policies, *i. e.*, not only (1) the Reserve for *Death* Benefits; but also (2) Reserve for *Disability* Benefits, as computed for (*a*) *Active* Lives, and (*b*) *Disabled* Lives, saying (R47-48):

> "The reserves here in issue are additional reserves set up under the policies containing disability provisions *to meet future unaccrued and contingent liabilities* under those provisions. These reserves are in all essentials like those involved in *Equitable Life Assurance Society*, 33 B. T. A. 708, and which we there held met the statutory description of 'reserve funds required by law.' One of the reserves in the *Equitable* case was called 'additional reserve on noncancellable accident and health policies.' That reserve is like the one here called the '*active life reserve*,' and was maintained, in both cases, *to meet*

> *anticipated but unaccrued claims under those policies where the insured had not incurred disability within the year.* The other reserve in the *Equitable* case, called 'reserve for unpaid and unresisted accident and health claims' is like the one this petitioner calls its '*disabled* life reserve.' *This reserve was maintained in both cases to provide for the payment of benefits expected to arise in the future from disabilities already incurred by policyholders.*"

B. T. A., *first,* sustained the deduction based on *Active* Life Reserves, upon the authority of the *Equitable Life* and *Monarch Life* cases [33 B. T. A. 708; 38 B. T. A. 716]. *Secondly,* it sustained the deduction based on the *Disabled* Life Reserve upon the authority of the *Pan-American Life* case [38 B. T. A. 1430] saying (R49):

> "That reserve [*Pan-American Life* case] is identical with the one that this petitioner calls a disabled life reserve. The policies involved in the *Pan-American* case, as here, were life insurance policies containing provisions for disability benefits. The reserves there, as here, were carried to enable the company to pay benefits in cases *where disabilities had occurred* but where the benefits were *not* then payable . . . we hold the petitioner [Oregon Mutual] entitled to deductions based on its active and disabled life reserves carried under the disability provisions of its life insurance policies."

The C. C. A. (9th) *affirmed* that decision in *Commissioner* v. *Oregon Mutual Life,* 112 F. (2d) 468, saying:

> "Since the words 'reserve funds,' as used in the classification statute, embrace disability reserves held against *combined* life and disability policies, we see no persuasive reason to believe that they should be held to mean *less than that* when used in § 203(a)(2). **Had Congress intended a narrower application of the term for the purpose of the deduction, presumably it would have said so in apt language.** The words 'reserve funds required by law,' used in the latter section, unquestionably refer to technical insurance re-

serves. But we think, as in § 201(a), they comprehend reserves held to meet a life insurance company's obligations **dependent either upon life contingencies or upon life and disability contingencies."**

***Monarch Life Ins. Co.*, 38 B. T. A. 716: 114 F. (2d) 314 [C. C. A. 1st].**

In *Monarch Life Insurance Co.* 38 B. T. A. 716, Monarch Life issued **(1)** "*Non*-Disability" policies, and "Disability" policies, *i. e.*, policies of "*combined* life, health and accident insurance", and also **[2]** [*differently* from Oregon Mutual], *separate* policies of accident and health insurance (both cancellable and non-cancellable).

Monarch Life's Reserve under its "Disability" and "*Non*-Disability" policies was "more than 50%" of its "total Reserve funds" [for "Disability", "*Non*-Disability", and *separate* "accident and health insurance" policies]. Therefore, it was taxable as a "*life* insurance company"[36] under § 201(a).

**I. Disabled Life Reserve** *under policies of "combined life, health and accident insurance."* Monarch Life deducted 3¾% of its Reserve for Waiver of Premium Disability Benefits, with respect to policyholders already disabled. The Commissioner contested this. The B. T. A. held that "reserve funds" under § 203(a)(2) was *not* restricted to Reserve for Death Benefits only, but included this Disabled Life Reserve, saying (38 B. T. A. 718, 724-5):

> "Hence, this fund was designed to cover **future** claims that were **unaccrued and contingent**, since the claims accrued only as the total disability continued and there was no way of ascertaining in a given case how long the disability would in fact continue. In our opinion, petitioner's reserve fund for incurred

[36] In this case, it was a "life insurance company" [Class I], although in previous years it was not a *"life"* insurance company, but was a stock insurance company *other* than life [Class III] (See pp. 34-37, *supra*).

disability benefits comes squarely within the statute under the interpreting decisions above referred to, and we hold that respondent erred in disallowing the deduction claimed."

**II. Active and Disabled Life Reserves,** *under separate "accident and health" policies.*

**Active Life Reserves** — *Additional reserve on* [separate] *non-cancellable accident and health policies.*

**Disabled Life Reserves** — *Reserve for unpaid and unresisted claims.* [Un-accrued]

These Reserves [which were identical with those dealt with in the *Equitable Life* case, pp. 64; 75-77, *infra*] were exactly like Oregon Mutual's *Active* Life Reserves and *Disabled* Life Reserves, *except* that in the case of the Monarch Life, the reserves were held for *separate* "accident and health" insurance with *no element* of life insurance therein, *whereas,* Oregon Mutual's Active and Disabled Life Reserves were both held solely for the fulfillment of "*combined* life, health and accident insurance" policies.

The B. T. A. held that Monarch Life was entitled to the 3¾% deduction on both its Active Life Reserves and its Disabled Life Reserves saying (p. 724):

> "Two of the reserve funds involved herein, viz., the additional reserve on noncancelable accident and health policies [Active Life Reserve] and the reserve for unpaid and unresisted accident and health claims [Disabled Life Reserves] were considered by this Board in *Equitable Life Assurance Society of the United States,* 33 B. T. A. 708, and there held to be reserves required by law within the meaning of the Revenue Acts of 1924 and 1926, which contain provisions similar to the 1932 and 1934 Acts. Accord-

> ingly, in so far as the deficiencies result from the denial of deductions computed on the basis of the two reserve funds just mentioned, respondent's action is reversed and we hold for petitioner on authority of the cited decision."

In response to the Commissioner's contention that "reserve funds" in § 203(a)(2) extend "*only* in respect of reserves maintained for *death benefits* under *life* insurance policies"—which is the precise contention which the Commissioner makes here—the B. T. A. rejected that contention saying (p. 726):

> "This is a novel proposition, and we have been unable to find any authority to support it. Section 201 (a) of the Revenue Acts of 1932 and 1934, relating to the tax on life insurance companies, defines the term 'life insurance company' as meaning 'an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.' The parties to these proceedings have stipulated that more than 50 percent of petitioner's total reserve funds held during the taxable years were held for the fulfillment of life insurance contracts, and that petitioner was held to be taxable as a life insurance company. **If petitioner is taxable as a life insurance company, it must follow that its reserve funds must be treated as reserve funds of a life insurance company.** *Equitable Life Assurance Society, supra,* dealt with reserves on accident and health policies, such as are involved in the present proceedings, and they were there held to be a proper basis for allowable deductions. Respondent's position on this point, we think, can not be sustained, and his action is reversed."

This was *affirmed* in *Com'r* v. *Monarch Life,* 114 F. (2d) 314; where, with reference to the Disabled Life Reserves

for policies of "combined life, health, and accident insurance", the C. C. A. (1st) said:

> "The Commissioner contends that this is not a technical insurance reserve because, he says, it is maintained to pay claims which have already accrued or matured. The reserve is set up to insure against the continuance of the total disability by providing a fund to supply the premiums to be waived during the continuance of the disability. In order to receive the benefit of the waiver, the insured must be alive and totally disabled at the time a premium becomes due; and the waiver is contingent upon fulfillment of these conditions.
>
> The claim is not accrued because, though the disability has been incurred, the continuance of the disability is uncertain, and thus the waiver is contingent. The extent of the probable liability and the amount of the reserve created are fixed by reference to mortality and disability tables plus an assumed interest rate. When the premium becomes due and total disability exists, the premium is paid out of the reserve and is no longer a part of the reserve. It is clear that the reserve is held by the taxpayer against claims of insurance that are 'future', 'unaccrued', and 'contingent'. It is a true technical insurance reserve. *Commissioner* v. *Oregon Mutual Life Insurance Co.* (9 Cir., 1940), 112 F. 2d 468; *Commissioner* v. *Pan-American Life Insurance Co.* (5 Cir., 1940), 111 F. 2d 366; cf. *Equitable Life Assurance Society* v. *Com. of Int. Rev.* (1935), 33 B. T. A. 708. . . ."

Furthermore, with reference to all Reserves in controversy, including both Active and Disabled Life Reserves for *separate* accident and health policies, the C. C. A. (1st) also said:

> "It is stipulated that the reserve funds in the instant case were computed upon the basis of experience or actuarial tables; that an interest assumption was involved; and that the reserves were set up and maintained out of premiums. Though the stipulated

> facts in regard to the additional reserve for noncancellable health and accident policies are slightly ambiguous on these points, it is clear that the reserve is set up from premiums and based on experience tables with an assumed rate of interest. See *Massachusetts Protective Association, Inc.* v. *United States*, 1 Cir., August 6, 1940, 114 F. (2d) 304.
>
> All that remains to make these reserve funds technical insurance reserves is to show that they directly pertain to insurance, and were set aside and maintained for the purpose of maturing and liquidating either by payment or reinsurance with other companies, future, unaccrued and contingent claims. . . .
>
> The reserves in question fulfill all the requirements of the various definitions of a technical insurance reserve fund required by law. They also comply with the general definition set forth in Regulations 86, Section 203(a)(2)-1 (1935)."

**A fortiori**, this C. C. A. decision should control as to Oregon Mutual's $250,861.09 Reserves for Disability Benefits, because a large part of Monarch Life's policies were **separate** accident and health insurance, whereas Oregon Mutual's policies were contracts of **combined life, health, and accident insurance** (R93, 155-7; p. 11, *supra*).

***Pan-American Life*, 38 B. T. A. 1430: 111 F. (2d) 366 [C. C. A. 5th].**

In *Pan-American Life Insurance Co.*, 38 B. T. A. 1430, Pan-American (like Oregon Mutual) issued nothing but "*Non*-Disability" and "Disability" policies, *i. e.* "contracts of *combined* life, health and accident insurance". Only *Disabled* Life Reserves were involved.

The B. T. A. thus described the reserve funds in controversy (p. 1435):

> "To meet its **future unaccrued and contingent obligations** under these *combined* life, health, and accident policies, petitioner set up and held at the beginning

> and end of the taxable year several reserve funds . . . The fourth reserve, which is the one here involved, was set up by petitioner and held to meet its **future unaccrued and contingent obligation** to waive premiums or to waive premiums and to pay a monthly income, depending upon the type of policy, in cases of total and permanent disability where the insured had already become disabled."

**Disabled Life Reserves.** The B. T. A. held that Pan-American's Disabled Life Reserve [just described] was included in the phrase "reserve funds" [§ 203(a)(2)] [*a*]. With respect to the Waiver of Premium Disability Benefit it said (pp. 1438-9):

> " . . . the question at issue, at least as far as *premium waiver benefits* are concerned, is identically the same as the issue relating to the reserve for incurred disability benefits [Disabled Life Reserves] in the recent case of *Monarch Life Insurance Co.*, 38 B. T. A. 716. In that case we held that the reserve for incurred disability benefits (apparently involving *premium waiver benefits only*) was a reserve fund required by law and that the petitioner there was entitled to deduct from its gross income an amount equal to 3¾ per centum of the mean of such a reserve fund held at the beginning and end of the taxable year. It follows that, at least as far as *premium waiver benefits* are concerned, the instant proceeding is controlled by our holding in *Monarch Life Insurance Co., supra.* Cf. *Equitable Life Assurance Society of the United States* (reserve for unpaid and unresisted accident and health claims), 33 B. T. A. 708, 711" [See pp. 67-71, *supra,* pp. 75-77, *infra*].

With respect to the Income Disability Benefit, the B. T. A. said (p. 1439):

> "Regarding that portion of the reserve for incurred disability benefits [*Disabled* Life Reserve]

involving monthly *income* benefits, we know of no reason why it should be treated any differently from that portion of the reserve involving premium waiver benefits. The policies involving both kinds of benefits are substantially the same, except that in those involving both *premium waiver* and *monthly income* benefits the insured agrees to pay a larger additional premium than the insured pays in those policies involving premium waiver benefits only. We hold that both portions of the reserve for incurred disability benefits [*Disabled* Life Reserve] involved herein should be treated alike and that petitioner is entitled to deduct from its gross income the amount of $12,940.62 set out in our findings as representing 3¾ per centum of the mean of the reserve for incurred disability benefits held at the beginning and end of the taxable year."

The B. T. A. aptly answered the Commissioner's contention here that "reserve funds" in §203(a)(2) were *limited* to the Reserve for *Death* Benefits only in *life* insurance, saying (p. 1440):

"Neither do we think the Supreme Court in the *Inter-Mountain* and *Illinois Life* cases intended to construe the phrase 'reserve funds required by law' to mean only the reserve funds relating to *life* insurance. It seems to us that the structure of the act requires a recognition of other reserves. Sec. 201(a), *supra*, defines the term 'life insurance company' as one 'engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.' In this definition there can be no doubt but that Congress intended the term 'reserve funds' to apply to 'contracts of *combined* life, health, and accident insurance' as well as to 'life insurance and annuity contracts'. Therefore, it would seem to follow that the term 'reserve funds' in section 203(a)(2) would also apply to 'contracts of *combined* life, health,

and accident insurance', which is the type of policies involved in the instant proceeding. Any other construction of the act would be inconsistent with the respondent's allowance of the statutory per centum of the mean of the reserve for disability and accidental death benefits reported on line 2 of Schedule A of the return and briefly referred to at the beginning of this opinion. The only difference between that reserve [Active Life Reserve] and the one for incurred disability benefits [Disabled Life Reserve] is that in the latter the disability has *already* taken place. **But the insured must survive and remain disabled on each and every anniversary date of the policy before any actual liability accrues against petitioner."**

The C. C. A. (5th) *affirmed* the B. T. A., saying (*Com'r* v. *Pan-American Life* 111 F. (2d) 366):

"The nature of the reserve in dispute [Disabled Life Reserve] is persuasive to the conclusion we have reached. Incurred disability reserves were created only after the disability had arisen. They were *not* fixed obligations. They were payable only *in the future,* and were *contingent* upon the continuance of both life and disability. Not being completely accrued, the extent of the probable liability thereunder was computed, and the amount of the reserve created was fixed, by tables of probability based upon approved rates of termination of such liability. The method of computation so employed is wholly consistent with that used for establishing amounts of premiums and reserves for ordinary life-insurance and annuity contracts, and is wholly inconsistent with reserves created to defray accrued and definite liabilities payable in the future. This is the distinguishing feature between the case at bar and those relied upon by the Commissioner, which dealt with reserves for payment of accrued obligations for fixed amounts created by contract. The latter are mere solvency reserves having no relation to true insurance risks."

***Equitable Life Assur. Society*, 33 B. T. A. 708.**

In *Equitable Life Assur. Society*, 33 B. T. A. 708, Equitable Life issued *separate* policies of non-cancellable "accident and health" insurance.

[**Active Life Reserves.**] In order to meet its future, unaccrued and contingent obligation to pay sums to those of its healthy *Active* policyholders, who might, *in the future*, unfortunately become disabled, Equitable maintained a Reserve (there called "Additional Reserve on Non-Cancellable Policies"; called in the case at bar "*Active* Life Reserves", p. 64, *supra;* Item 8, p. 56, *supra*).

The Commissioner stipulated in that Record, and *conceded in his Brief*[37] that such Reserve was

> "computed upon the same actuarial principles as the reserve described . . . in item 8 of the liability page of the Life Statement"; [and was] "includible in the reserve funds required by law to be used in determining the deduction of '4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year.' "

The B. T. A. held that such "Additional Reserve on Non-Cancellable Policies", ["*Active* Life Reserves"] was included in the phrase "reserve funds" in § 203(a)(2), saying (p. 711):

> "Believing this *concession* to be proper and in line with the decisions in [citing 9 authorities], we deem it unnecessary to pursue the question further."

We thus see that in the *Equitable* case, the Commissioner stipulated and conceded—and the B. T. A. approved and held—that the technical insurance Reserve held by the Equitable Life for the performance of its **future, unaccrued**

[37] Paragraph XV, Agreed Statement of Facts, Dockets Nos. 31110, 33241 and 57867; 33 B. T. A., p. 711.

**and contingent** obligations to its policyholders in the event of **disability** [*Active* Life Reserves] was included in "reserve funds" in § 203(a) (2). This should be decisive as to Oregon Mutual's $111,127.58 *Active* Life Reserve (pp. 30, 44-45, 56, *supra*).

[**Disabled Life Reserves.**] Equitable Life's *Disabled* Life Reserve was held for the fulfillment of the weekly benefits which it might have to pay, *in the future*, to policyholders *already* disabled, *i. e.*, on account of disabilities which had *already commenced* (Disabled Lives), but where the disabled policyholders might, or might not, continue to live from week to week, to the successive weekly dates on which such disability benefits respectively became payable in the future (33 B. T. A. at pp. 711-712).

Ninety per cent (90%) [38] of the *Disabled Life Reserve* [ranging for the years in question from $350,000 to $1,500,000, 33 B. T. A. at p. 713, Table; p. 716] was

> "for the payment of benefits which will become due in the future, *if* the policyholders survive and remain disabled."

In respect of that 90% Reserve, the Commissioner stipulated: [39]

> "For both cancellable and non-cancellable policies this reserve is held for the same purpose as reserve item 9 of the Life Statement form [New World's *Disabled* Life Reserve.] For non-cancellable policies

[38] The other 10% of that Reserve was "held for the payment of benefits which *have accrued* and *are unpaid*, in respect to disabilities which *have already commenced*" Equitable Life conceded, and B. T. A. properly held that such 10% was *not* included in the term "reserve funds required by law" within the meaning of § 203(a)(2) [or its identic predecessor, § 245(a)(2); 33 B. T. A. at p. 712] because the weekly benefits in question [for which such 10% was held] had *already accrued and were unpaid*; and such claims fell squarely within the items (3)-(5) summarized at p. 26, *supra*. **New World has never claimed any deduction of that character.**

[39] Paragraph XVI, Agreed Statement of Facts, Dockets Nos. 33241 and 57867.

this second element of the reserve since January 1, 1926, has been calculated in the same manner as item 9 of the Life Statement form." [Oregon Mutual's *Disabled* Life Reserve.]

The B. T. A. held that such 90% Reserve was included in "reserve funds" [§ 203(a) (2).] This 90% Reserve was exactly the same thing that Oregon Mutual calls its Disabled Life Reserve (p. 64, *supra*).

**A fortiori**, this B. T. A. decision should control as to Oregon Mutual's $139,733.51 Disabled Life Reserve, because the Equitable Life's policies were *separate* accident and health insurance, *whereas* Oregon Mutual's policies were "contracts of *combined* life, health and accident insurance" (pp. 11, 13-14, 30, 46, 47, *supra*).

## IV. Commissioner's Authorities Distinguished.

The Commissioner relies on *Helvering* v. *Inter-Mountain Life*, 294 U. S. 686, and *Helvering* v. *Illinois Life*, 299 U. S. 88, *first*, as justifying the Commissioner's attempted retroactive Regulations 86, p. 298 (p. 62, *supra*); and, *secondly*, to support his action contrary to Regulations 86 [p. 62, *supra*] in limiting Oregon Mutual's 3¾% deduction to "reserve funds" for *Death* Benefits only (New World R. 52, 53, 57).[40]

Neither the *Inter-Mountain* case nor the *Illinois Life* case supports the Commissioner's contention.

These two cases will now be analyzed.

**1. Helvering v. Inter-Mountain Life, 294 U. S. 686:** Attached to the life insurance policies were a series of annual coupons, by which Inter-Mountain Life agreed (1) to pay the policyholder, at maturity each year, the amount

[40] *New York Life* v. *Edwards*, 271 U. S. 109, is reviewed at p. 83, *infra*.

of the coupon, or (2) at the insured's option, to hold the amount of the coupon at interest,—payable on demand, or at death, or convertible into insurance or annuity. The laws of Utah required a reserve necessary to cover that coupon liability.

Inter-Mountain Life "carried a separate [$136,523.39] reserve against matured, unsurrendered and unpaid coupons". The question involved was whether "reserve funds" in § 203(a)(2) embraced that $136,523.39.

That $136,523.39 "separate reserve" measured the company's liability for *present, unpaid, matured, accrued* and *non*-contingent "coupon" obligations, the payment of which had to be made at any time on demand, and which was wholly independent of any life contingency whatsoever.

This Court emphasized that the "liability on the matured coupons, depends upon *no contingency*" (p. 690). They were like *unpaid* death losses or *unpaid* dividends (p. 40, Items 3, 8, *supra*). They were *solvency* reserves, *with no relation to insurances;* **whereas**, Oregon Mutual's reserves, pertained directly to *life* insurance, and had *no characteristics* of so-called "solvency reserves".

The B. T. A. aptly said, *Pan-American* case, 38 B. T. A. 1439-1440:

> "The reserve funds involved in the other two cases [*Inter-Mountain Life* and *Illinois Life*] were in the nature of solvency reserves and were essentially different from the one which we are now considering. For instance, the reserve in the *Inter-Mountain* case, supra, was against matured, unsurrendered, unpaid coupons, and was *not* essentially an *insurance* reserve. Inter-Mountain's liability thereon depended upon no contingency. The insured there at any time could have withdrawn the matured coupons in cash. . . . Neither do we think the Supreme Court in the *Inter-Mountain* and *Illinois Life* cases intended to construe the phrase 'reserve funds required by law' to mean only the reserve funds relating to *life* insur-

ance. It seems to us that the structure of the act requires a recognition of other reserves."

Oregon Mutual's **$250,861.09** Disability Reserves [Active and Disabled] were entirely different, in that they were the mathematically calculated measure of its liability for **future, unaccrued and contingent** policy obligations to pay Disability Benefits. **These obligations were entirely in the future; they had not yet accrued; and their payment was dependent upon life and disability contingencies.**

**This Court's reference to "life insurance" and "life insurance elements" and "life reserve" was simply because the policies in question were "Non-Disability" policies; and since the policies had no Disability Benefits, the Court was only concerned with Death Benefits, ordinarily called life insurance.**

**2. Helvering v. Illinois Life Ins. Co., 299 U. S. 88:** The policies provided that, out of each year's premium (after the first), a certain sum should be set aside for a "survivorship investment fund", to be invested at 3½% compound interest; and, at the end of twenty years, the fund should be divided among the persistent survivors of the "group". The "survivorship investment fund" was $3,343,982.67,—4% of which was deducted under § 203(a)(2).

Following the *Inter-Mountain Life* case, this Court rejected the deduction, and held that "reserve funds" in § 203(a)(2) did not embrace the $3,343,982.67 "survivorship investment fund".

While Illinois Life had a future and unaccrued obligation to apportion the "survivorship investment fund" among a group of policyholders at a future date, yet that obligation lacked the essential element of "reserve funds" in that such obligation **did not in the slightest degree depend upon any life, disability, or other contingency.** Illinois

Life's obligation was *an unconditional and non-contingent obligation, i. e.,* to pay the specified sum which each policyholder had paid into the fund *plus* a fixed rate of interest thereon; and Illinois Life's obligation to pay whatever aggregate amount was paid in by policyholders *plus* a fixed interest rate thereon, **did not depend upon whether any one or more policyholders lived or died.**

Consequently, the *liability* to pay the fund **was not dependent upon a life or disability contingency.** This Court thus aptly expressed that idea saying (p. 90):

> "Under these policies the company's liabilities on account of the investment funds are **independent** of those attributable to life insurance risks. The right to participate in the investment funds **is not dependent upon death of the insured.** The company's liability is the total of contributions to the fund plus the interest agreed to be paid. It is bound to discharge this liability at the end of 20 years. • • • The survivorship investment fund feature of these policies has no relation to life insurance risks."

Illinois Life's "survivorship investment fund" had no element either of *insurance,* or of *risk.* That is where it differs from Oregon Mutual's **$250,861.09** Disability Reserve which measures the liability for an *insurance* obligation *dependent upon life and disability contingencies.*

Illinois Life's policies were "*Non*-Disability" policies; and hence, as in the *Inter-Mountain Life* case, this Court's references to "*life* insurance", "*life* insurance risks" and "*life* insurance liability" were because the policies in question *were* ordinary *life* insurance policies with Death Benefits only; and there was no occasion for this Court to refer to the *future, unaccrued* and *contingent* disability obligations under "Disability" policies.

The B. T. A. acutely remarked (38 B. T. A. 1440):

> "Likewise, in the *Illinois Life* case, *supra,* the reserve for survivorship investment funds was *not*

a reserve set aside to mature or liquidate any future unaccrued and contingent claims. Illinois Life was bound at the end of 20 years to discharge a definite liability consisting of the total contributions to the fund plus the interest it had agreed to pay. The reserve set up to meet this definite liability was in substance nothing more than a solvency reserve."

In the *Monarch Life* case, the C. C. A. (1st) also distinguished the *Illinois Life* and *Inter-Mountain Life* cases, saying (114 F. (2d) at p. 325):

> "While certain language in *Helvering* v. *Illinois Life Insurance Co.*, supra, appears to sustain the Commissioner's contention that the reserves must be technical life insurance reserves, an examination of all the cases shows that this is not true. 'The language used in an opinion must be read in the light of the issues presented.' *Sinclair* v. *United States*, 279 U. S. 749, 767. In the *Illinois Life Insurance Co.* case, as in *Helvering* v. *Inter-Mountain Life Insurance Co.*, and *Continental Assurance Co.* v. *United States*, supra, also relied on by the Commissioner, the court distinguished between life insurance reserves and 'solvency' reserves. There was no question of drawing any line between life insurance reserves and other true insurance reserves. The only reserves to which the language could refer in all three cases were life insurance reserves. The question here presented was not in any manner raised. The *Illinois* case expressly approved the *Inter-Mountain* decision where the court said that reserves cannot "include values that do not directly pertain to insurance" (294 U. S. 686, 690) with no words restricting the language to "life" insurance. And the *Inter-Mountain* case approved the holding of the Court of Claims in the *Continental Assurance Co.*, supra, decision that "the reserve intended by the taxing act as a deduction is the amount set aside from premiums and built up by interest accretions to meet existing unmatured insurance, whether fire, marine, or life insurance" 8 F. Supp. 474, 478. The reserves in question here

come completely within this definition, and it is our opinion that *Helvering* v. *Illinois Life Insurance Co.*, supra, intended in no way to limit this definition. *Commissioner* v. *Oregon Mutual Life Insurance Co.*, supra; *Pan-American Life Insurance Co.* v. *Comm. of Int. Rev.*, 1938, 38 B. T. A., 1430, 1438, affirmed, 5 Cir., 1940, 111 F. 2d 366."

**3.** In the *Inter-Mountain* and *Illinois Life* cases, this Court had no thought of confining "reserve funds" to *Death* Benefits only, because,

(*a*) § 201(a) explicitly *includes* reserve for Disability Benefits, in the "reserve funds" with which §§ 201-203 deal (pp. 28-30, *supra;* 38 B. T. A. 726; *Id.* 1440).

(*b*) "Reserve funds" embraces reserves for **Disability** Benefits for the very purpose of *defining* a *"life* insurance company" **so as to render it taxable.** Therefore, "reserve funds" in §203 must also embrace reserves for the same **Disability** Benefits, when used in fixing the *amount* of the tax imposed by those same words in § 201 (*Id.*).

Obviously, neither Congress nor this Court intended that the *same words* should have one meaning in § 201 in order to make the company taxable at all, and a *different* meaning in § 203, in fixing the *amount* of the tax imposed by the *same words.*

(*c*) "Reserve funds" has been recognized as embracing reserves for Disability Benefits (1) in every Revenue Act since 1909, (2) in all the Regulations promulgated thereunder, and (3) in the Commissioner's administrative practice,—until the Commissioner suddenly changed his mind in 1936 (Cf. 38 B. T. A. 1436-8, pp. 55-56, 60-62, *supra,* for a discussion of this subject).

(*d*) To so hold, would compel life insurance companies to pay taxes upon the whole of its interest earnings on its Disability Reserves, the greater part of which

interest is required to maintain the Reserve which the company is required by law to hold as Reserve to meet their *future, unaccrued* and *contingent* obligations for Disability Benefits. Such a holding would destroy the whole basis for taxation under the 1921 and subsequent Acts.

(*e*) This Court certainly did not intend that a few expressions which it *correctly used* in the *Inter-Mountain* and *Illinois Life Cases* [with reference to the particular kind of insurance involved in thoses cases, (*i. e.* life insurance with *Death* Benefits only)], should be wrenched from the context, and applied (as the Government urges) to entirely different *kinds* of policies **not involved in those cases;**[41] especially as this Court has suggested more than once that "reserve funds" as used in the Federal taxing Acts must be construed so as to cover varying situations which arise for one company in *one kind of business,* not present in some other company with a *different* kind of business. (*U. S.* v. *Boston Ins. Co.*, 269 U. S. 197, 203.)

*New York Life* v. *Edwards,* 271 U. S. 109, is not in conflict with Oregon Mutual's contention, because the questions there involved were entirely different from those involved here.

**4. New York Life v. Edwards, 271 U. S. 109.** The 1913 Revenue Act permitted New York Life to deduct *"the net addition,* if any, *required by law* to be made within the year *to reserve funds".*

New York Life's 1913 Annual Statement [made on the Superintendent of Insurance's official blank] duly reported its Reserve (Items 1-7) and its other Liabilities (Items 9-47). It included its Disabled Life Reserve as a *specially*

[41] *Webster* v. *Fall,* 266 U. S. 507, 511; *U. S.* v. *Mitchell,* 271 U. S. 9, 14; *Sinclair* v. *U. S.*, 279 U. S. 749, 767.

*interpolated* Item 9a, among the company's *other Liabilities*, such as those for unpaid salaries, bills, legal fees, death losses, commissions, dividends and other claims "*not* involving life contingencies" (pp. 39-41, *supra*).

The items material to the case were as follows:

| Item. | |
|---|---|
| "8. Net Reserve (Paid-for-basis) | $625,747,810". |
| "9a. Present value of future premiums waived on account of total and permanent disability | $16,629". |

The Superintendent of Insurance of New York did not "require", nor even treat, the $16,629 Disabled Life Reserve as any part of New York Life's "Net Reserve"; but, on the contrary, he "*required*" it to be reported among the *unpaid* bills, taxes, salaries and other *accrued* items *not* involving life contingencies (pp. 39-41, 78, 80, *supra*). Therefore, this Court properly rejected New York Life's $16,629 deduction, because,

(*a*) The Agreed Statement of Facts *failed to show* that the $16,629 was the mathematically calculated measure of New York Life's liability for *future, unaccrued* and *contingent* obligations to pay Disability Benefits under its "Disability" contracts; and

(*b*) The Agreed Statement of Facts not only (i) *failed to show* any *law* that *required* the $16,629 as a reserve, but (ii) it affirmatively *showed* that the Superintendent of Insurance of New York *required* this item to be reported as an ordinary *liability*, and *not* as a part of the "Net Reserve", *i. e. not* as a *reserve* "required by law".

This Court said (p. 118):

> "The Circuit Court of Appeals held the deduction should have been allowed, but we think otherwise.
>
> The Superintendent of Insurance of New York *required* this item to be reported as a *liability* and did not treat it as part of the general reserve. Upon the agreed facts *we cannot say* that it was part of any

> reserve required by the laws of New York. There is nothing to show *how* "the value of the contractual benefits" under these policies was arrived at and, *considering the evidence presented, we must accept* the Superintendent's conclusion. The Company *has not shown enough* to establish its right to the exemption."

This Court's decision could not possibly have been otherwise upon the facts revealed in the Record; but it is very significant that this Court apparently recognized that, logically, the $16,629 Disabled Life Reserves *were perhaps,* in a proper case, deductible; because, it so carefully limited its decision by the cautious expressions: "we cannot say", "there is nothing to show", "considering the evidence presented", "we must accept" and the New York Life "has not shown enough" etc., etc.

While a small part of the same kind of Reserve was involved in both cases, [*i. e.* Reserve for Waiver of Premium only] **the facts in the New York Life case were entirely different from the uncontradicted facts established**; because

(*a*) Oregon Mutual *did demonstrate how* its $250,861.09 Reserve for Disability Benefits [$111,127.58 Active Lives and $139,733.51 Disabled Lives] was the *mathematically calculated measure* of Oregon Mutual's liability for its *future, unaccrued* and *contingent* obligations to pay Disability Benefits (R67-112, pp. 14, 41-42, 43-48, *supra*);

(*b*) The B. T. A. and C. C. A. expressly found, and the Commissioner conceded, that the law of Oregon *"required"* this $250,861.09 as the mathematically calculated Disability Reserve (R47; pp. 13, 38-39, 50, *supra*).

The foregoing analysis shows that this Court's disallowance of New York Life's $16,629 "Disabled Life Reserve" is absolutely no precedent here for disallowing Oregon Mutual's Disability $250,861.09 "Reserve" because of the totally different facts shown in the two cases.

## CONCLUSION.

**In No. 2 the Court of Claims' judgment should be reversed.**

**In No. 564, the C. C. A. (9th) judgment should be affirmed.**

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A. B. WINFREE,
*General Counsel for Oregon Mutual Life.*

November 13, 1940.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1940.

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No. 2.

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NEW WORLD LIFE INSURANCE CO., *Petitioner,*

v.

THE UNITED STATES.

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**On Writ of Certiorari to the Court of Claims.**

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## PETITIONER'S REPLY BRIEF.

---

### PRELIMINARY.

The respondent raises for the second time in his brief the question of whether the writ of certiorari herein should be dismissed, which was previously raised in respondent's motion to dismiss the writ. This motion this Court denied on October 14, 1940.

Petitioner's reply brief will discuss the question referred to above, as well as certain other contentions made by respondent, particularly its request that this Court reconsider its decision in *Helvering* v. *Reynolds Tobacco Co.*, 306 U. S. 310.

## STATEMENT.

On September 24, 1940, respondent filed a motion in this Honorable Court to dismiss the writ of certiorari, on the ground that the question presented by the writ was moot. On September 30, 1940, the petitioner filed a brief in opposition to respondent's motion to dismiss the writ. In addition to the facts stated in respondent's said motion, the petitioner showed that it had another suit pending in the Court of Claims, *New World Life Insurance Company* v. *U. S.*, No. 44580, involving the question of whether petitioner is entitled to deductions of $5,376.90 and $5,417.88 for the years 1933 and 1934, respectively, representing 3¾ per cent of the mean of its Disabled Lives Reserves, an identical question now presented by the present writ, and that the dismissal of the writ would result in compelling the petitioner and the respondent to litigate the same question anew in the Court of Claims, a procedure expensive to the petitioner and to the Government, as well as an unnecessary burden upon the Court of Claims and this Honorable Court. (Pet. Br. in Opp., 2, 3.)

At the time of filing petitioner's said brief in opposition to the granting of the respondent's said motion to dismiss the writ on September 30, 1940, petitioner filed a "Motion for Leave to File Waiver of Statute of Limitations and Consent to Judgment" for the year 1931; and petitioner attached to its said motion a duly executed "Waiver of Statute of Limitations and Consent to Judgment" for the year 1931. (Pet. Br. in Opp., 6-9.)

This Honorable Court did not pass upon petitioner's said motion for leave to file said waiver and consent to judgment, and petitioner is not clear as to whether this Court gave any consideration to the same. Petitioner submits, however, that it had the unqualified right to file said Waiver of Statute of Limitations and Consent to Judgment without leave of this Court (37 *C. J.* 721); and that petitioner's said Waiver of Statute of Limitations and Consent to Judgment for the year 1931 was properly filed in this Court on September 30, 1940.

The Commissioner's Regulations from 1921 to 1935 authorized a life insurance company to take a deduction of the statutory percentage of the mean of the Active Lives Reserve and of the Disabled Lives Reserve. Furthermore, Form 1120-L (corporate life insurance income tax return for the years 1921 to 1932, prepared by the Commissioner) contained lines for said deduction.

On February 11, 1935 the Commissioner, with the approval of the Secretary of the Treasury promulgated Reg. 86, Art. 203 (a) (2)-1 under the Revenue Act of 1934, in which he omitted the authorization for the deduction in respect of Active Lives Reserves and Disabled Lives Reserves but did not specifically deny said deductions, with the exception that said regulations specifically stated that reserves held on account of waiver of premiums were not reserve funds required by law within the meaning of the Revenue Act of 1934.

It was not until December 18, 1935, that the Commissioner promulgated T. D. 4615, amending Art. 681 of Reg. 62, 65, and 69, applicable to the Revenue Acts of 1921, 1924, and 1926, respectively, and Art. 971 of Reg. 74 and 77, applicable to the Revenue Acts of 1928 and 1932, respectively, so that these regulations would conform to Art. 203 (a) (2)-1 of Reg. 86.

Art. 681 of Reg. 62, 65, and 69, Art. 971 of Reg. 74 and 77 as originally promulgated and as amended, as well as Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), Art. 203 (a) (2)-1 of Reg. 94 (1936 Act), and Art. 203 (a) (2)-1 of Reg. 101 (1938 Act) contained a specific authorization for a deduction with respect to disability reserves *not required by law* in the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation. (Appendix, p. 21.) For some reason respondent saw fit to omit this provision of the regulations. (Appendix, Resp. Br. 56.)

## ARGUMENT.

### I.

### The Respondent is Precluded From Raising the Moot Question Issue Again at This Time.

**The question is res judicata.**

No new facts have been presented by the respondent in its brief which were not set out in its original motion to dismiss the writ and in the petitioner's brief in opposition. It is submitted that the question is *res judicata*, and particularly that the respondent is not entitled at this time to reopen the question without a showing of new material facts which were not available to respondent at the time its original motion was filed.

In *Patterson* v. *Ford*, 8 Pac. (2d) 1006, 167 Wash. 121, the Supreme Court of the State of Washington held that where a respondent filed a motion to dismiss an appeal on the ground that it was defective and later renewed its motion on the same ground, the question was *res judicata*. We quote as follows:

> "Respondents move that the appeal be dismissed upon the ground that the bond on appeal is not in compliance with the requirements of section 1722, Rem. Comp. Stat.
>
> "This is a renewal of respondents' motion which was heard in this court and denied September 25, 1931. The matter is now *res judicata*."

In *H. L. Doherty & Company* v. *Youngblut*, 185 Pac. 257, 66 Colo. 594, the Supreme Court of Colorado on the question of a second motion to dismiss held as follows:

> "The defendants in error move to dismiss on several grounds. The plaintiffs in error answer that defendants in error cannot do this, because they have already moved and failed, and the present grounds were available at the time of the former motion, and plaintiffs in error call attention to the fact that since the former

motion they have expended large sums in the preparation and printing of abstracts and briefs.

* * * * * * * * *

"We think the position of plaintiffs in error is sound.

* * * * * * * * *

"The motion to dismiss is denied."

In *Bisbee* v. *Whitmore*, 241 N. W. 162, 257 Mich. 178, a supplemental brief was filed asking reconsideration of a previous motion to dismiss the appeal, and the court declining to do so said:

> "After this case was submitted to this court, plaintiffs filed a 'supplemental brief,' asking reconsideration of their motion to dismiss the appeal, which was denied January 5, 1931. Reconsideration, if desired, must be timely moved. No new reasons are alleged nor points other than those we then passed upon are submitted. We decline to reconsider our former adjudication."

On the same question the Court of Appeals of Illinois in *Elliott, Administrator* v. *Trandel*, 277 Ill. App. 359, after denying a first motion, declined to grant a second motion to dismiss an appeal. We quote:

> "In support of the judgment appealed from, the plaintiff contends that the bill of exceptions should be stricken from the record and the appeal dismissed. The plaintiff has previously made a motion to that effect in this court and on December 13, 1921, the motion was denied. It will, therefore, not again be considered at this time."

**The Rules of This Court Bar Reconsideration of the Questions Raised in Respondent's Motion.**

Paragraph 3 of Rule 7 of this Court, provides

> "A motion by respondent to dismiss a writ of certiorari or by appellee to dismiss an appeal after the court has ruled upon the jurisdictional statements and accompanying motions, if any (Rule 12, par. 5), will be re-

> ceived if not *based upon grounds already advanced in opposition to the granting of the writ of certiorari or to the noting of jurisdiction of the appeal.*"

If a respondent be not permitted to file a motion to dismiss a writ of certiorari, after he has already advanced the same grounds in opposition to the granting of the writ, *a priori*, the respondent in this case should not be permitted to reopen the identical question, which was presented in respondent's original motion to dismiss the writ and, which was considered by this Court in denying the respondent's said motion.

Presumably, the respondent will attempt to argue the question of whether the issue presented by the writ is moot, which will be in violation of Paragraph 2 of Rule 7 of this Court, which reads:

> "Oral argument will not be heard on any motion unless the court specially assigns it therefor, when not exceeding one-half hour on each side will be allowed."

If the respondent desired the Court to reconsider its original motion to dismiss, the respondent should have filed a petition for a rehearing within twenty-five days after October 14, 1940, as provided in Rule 33; and even that rule, which reads as follows, does not permit oral argument:

> "Such a petition is not subject to oral argument, and will not be granted, unless a justice who concurred in the judgment desires it, and a majority of the court so determines."

**Authorities Cited by Respondent Do Not Support Its Contention.**

Respondent cites *California* v. *San Pablo & C. Ry. Co.*, 149 U. S. 308, as authority for the proposition that the pendency of other cases does not justify this Court's retention of a case in which a moot question is involved. (Resp. Br. 17.) That case, however, is one in which entirely different

parties in entirely different suits had stipulated that said other cases should abide the decision of the Supreme Court in the case at bar. This Court declined to decide the case on the merits because the question was moot, and dismissed the writ of error. That is entirely different from a situation such as the instant one, in which the identical parties have an identical question pending in another suit in the identical courts; viz., the Court of Claims and the Supreme Court.

Respondent argues that this Court is precluded from deciding the instant case on the merits on account of the Declaratory Judgments Act, which is inapplicable to Federal Taxes. (Resp. Br. 16.) That Act, of course, does not apply here, inasmuch as no suit was instituted by petitioner in the Court of Claims for a declaratory judgment. In the event that this Court decides the instant case on the merits, its decision will be binding on the petitioner and the respondent in the other case pending in the Court of Claims.

## II.

### The Filing of Waiver of Statute of Limitations and Consent to Judgment Sufficed to Keep the Question Alive at All Events.

As pointed out in petitioner's brief in opposition to respondent's motion to dismiss the writ, the question presented by the writ did not become moot, if at all, until this Court denied the petition for a writ of certiorari with respect to investment expenses on May 20, 1940.

On September 30, 1940, petitioner filed in this Court a Waiver of Statute of Limitations and Consent to Judgment for 1931. Clearly the filing of petitioner's said Waiver of Statute of Limitations and Consent to Judgment for 1931 is sufficient to keep the question alive for 1931, if this Court should decide that the pendency of the other suit in the Court of Claims alone is insufficient for that purpose. (37 C. J. 721.)

Petitioner submits, therefore, that respondent is precluded at this time from renewing its motion to dismiss the writ; and that the question presented by the writ is not moot, because there is pending another case in the Court of Claims, and there is on file in this Court a Waiver of Statute of Limitations and Consent to Judgment for 1931.

If, however, the Court should dismiss the writ, petitioner respectfully asks the Court to reverse the Court of Claims on the reserve fund question in accordance with the usual practice of this Court. (*Leader* v. *Apex Hosiery Co.*, 302 U. S. 656; *Woodring* v. *Clarksburg Bridge Company*, 302 U. S. 658; *Alejandrino* v. *Quezon*, 271 U. S. 528; *Broconlow* v. *Schwartz*, 261 U. S. 216, 218; *Heitmuller* v. *Stokes*, 256 U. S. 359; *Commercial Cable Co.* v. *Burleson*, 250 U. S. 360; *Public Utilities Comrs.* v. *Compania General de Tabacos*, 249 U. S. 425; *Berry* v. *Davis*, 242 U. S. 468, 470; *U. S.* v. *Hamburg Amerikanische Co.*, 239 U. S. 466.)

## III.

### Granting Petitioner a Deduction in Respect to Its Disability Reserves Does Not Favor Petitioner Over Other Classes of Insurance Companies.

Respondent contends that the statute accords a life insurance company "unusually favorable treatment" (Resp. Br. 21); that the deduction of the statutory percentage of the mean of reserve funds gives a life insurance company "a unique deduction of unusual magnitude" (Resp. Br. 22); and that to permit a life insurance company to take a deduction in respect of its disability reserves would favor such a company over other classes of insurance companies, inasmuch as no such deduction is available to them. (Resp. Br. 23, 29.) At another place respondent refers to this deduction as a "windfall" to insurance companies. (Resp. Br. 47.)

Petitioner respectfully submits that the foregoing statements of the respondent are based upon a misapprehension

of the general scheme of taxation which Congress provided for the various classes of insurance companies; that other insurance companies receive the equivalent of the deduction of the statutory percentage of the mean of reserve funds given to a life insurance company; and that to deny a life insurance company a deduction in respect of disability reserves in fact would discriminate aginst such a company in favor of other classes of insurance companies.

Congress provided for the taxation of insurance companies according to three different classifications; viz.,

(1) "Tax on life insurance companies," (Secs. 201-203);

(2) "Tax on insurance companies other than life or mutual," (Sec. 204);

(3) "Tax on mutual insurance companies other than life."[1] (Sec. 208.)

Under this scheme of taxation, these three classes of insurance companies are taxed as follows:

"Life insurance companies" include in gross income only income received from investments, such as dividends, interest and rents, excluding therefrom premium receipts. (Sec. 202 (a).) They are not allowed any deduction for amounts actually paid to policyholders in satisfaction of claims; but life insurance companies are allowed a deduction of an amount equal to 3¾% or 4% of the mean of reserve funds required by law, which reserve funds are set up for the purpose of ultimately paying claims under their policies when they mature. (Sec. 203 (a) (2).) "Life insurance companies," therefore, are not taxed on premium receipts or on that portion of investment income added to reserve funds maintained to pay policyholders' claims when they mature.

Insurance companies "other than life or mutual" include in gross income, investment income and premiums earned. (Sec. 204 (b) (1)-(5).) They are allowed deductions for

[1] See Appendix, Respondent's brief, for the statutes applicable to the foregoing classes of insurance companies.

"losses incurred;" *i.e.*, losses actually paid to policyholders in satisfaction of claims. (Sec. 204 (b) (6).) "Insurance companies other than life or mutual," therefore, are not taxed on that portion of premium receipts or investment income used to pay policyholders' claims.

"Mutual insurance companies other than life" include in gross income, investment income, premium receipts, and all other classes of income. (Sec. 208 (a).) They are allowed to deduct amounts actually paid to policyholders in satisfaction of claims (Sec. 208 (c)), and also "the net addition required by law to be made to reserve funds" (Sec. 208 (c) (1) (A).), as well as certain other deductions. "Mutual insurance companies other than life," therefore, are not taxed on that portion of premium receipts, or on that portion of investment income, which is actually paid in satisfaction of policyholders' claims.

Thus it will be seen that under each of the three plans of taxing insurance companies, Congress has not taxed any class of insurance companies on that portion of premium receipts, or on that portion of investment income, which currently or ultimately is used to satisfy policyholders' claims. The method of accomplishing this varies; but the result is the same. For instance, life insurance companies get their deduction from gross income at the time the amounts are *set aside* in reserve funds, which ultimately are to be used to pay policyholders' claims; whereas, insurance companies other than life or mutual and mutual insurance companies other than life get their deduction when the losses are actually paid.

Hence it is clear that if petitioner were to be denied a deduction of the statutory percentage of its active Lives and Disabled Lives Reserves, which amounts ultimately are used to pay disability claims arising under its policies of combined life, health and accident insurance, instead of being favored, as argued by respondent, petitioner would be discriminated against as compared with other insurance companies, inasmuch as such other insurance companies

would receive the equivalent of such deduction at the time they paid their policyholders' claims, whereas petitioner would not receive any deduction either at the time the amounts were set aside in reserve funds or at the time the claims actually were paid.

From the foregoing, it is apparent that there is no basis for respondent's statement that the reserve deduction given to life insurance companies is "a unique deduction of unusual magnitude," or a "windfall" deduction, or that such deduction favors life insurance companies over other kinds of insurance companies.

## IV.

### Colloquy Between a Senator and Treasury Representative Not Admissible.

Respondent refers to a certain colloquy between Senator McCumber and Dr. Adams at the time the Revenue Act of 1921 was under consideration as evidence of the congressional intent that health and accident insurance reserves held in respect of policies of *combined* life, health and accident insurance should not be combined with life insurance reserves for the purpose of determining whether an insurance company is a life insurance company within the meaning of Sec. 201(a). (Resp. Br. 25-26.) Even though the interpretation placed upon this colloquy by respondent is correct, nevertheless this Court will not resort to such evidence for the purpose of construing an Act of Congress, as it has been held repeatedly that resort may not be had even to debates of Congress in connection with a bill at the time it is under consideration. (*United States* v. *St. Paul, M. & M. R. Co.*, 247 U. S. 310, 62 Law Ed. 1130; *Standard Oil Co.* v. *United States*, 221 U. S. 1, 55 Law Ed. 619; *Omaha & C. B. Street R. Co.* v. *Interstate Commerce Commission*, 230 U. S. 324, 57 Law Ed. 1501; *Lapina* v. *Williams*, 232 U. S. 78, 58 Law Ed. 515; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 75 Law Ed. 1183; *Humphrey* v. *United States*, 295 U. S. 602, 79 Law Ed. 1611.)

## V.

### Helvering v. Reynolds Tobacco Co., 306 U. S. 310, Correctly States the Rules Regarding Retroactive Regulations.

Respondent argues feebly that the application of the amended regulations is not prohibited by the decision of this Court in the *Reynolds Tobacco* case. By requesting this Court to reconsider its decision in that case, the respondent tacitly admits that the Commissioner is prohibited from applying his amended regulations to taxable years prior to 1934.[1] (Resp. Br. 37.)

This Court held in the *Reynolds Tobacco* case that where the statute is so general in terms as to render an interpretative regulation appropriate, and Congress has repeatedly reenacted the statute without change, the Commissioner may not amend his regulations and apply them retroactively except to correct misinterpretations, inaccuracies, or omissions in the existing regulations.

Respondent now argues that the Treasury has "*full and complete discretion* to determine to what extent changes in regulations are to operate retroactively" (Resp. Br. 45), and that in the event that the *Reynolds Tobacco* case be deemed to be in conflict with this theory, that case should be overruled. (Resp. Br. 47.)

Petitioner respectfully submits that the decision of this Court in that case lays down a sound rule, which is equitable to the government and to taxpayers and that Congress did not intend to give to the Treasury Department the absolute power to change regulations at will and to apply them arbitrarily to past years irrespective of prior administrative practice.

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[1] The only basis for respondent's contention that the *Reynold's Tobacco* case does not prohibit him from applying his amended regulations retroactively is that the original regulations did not correctly interpret the statute. That the prior regulations correctly interpreted the statute, we demonstrated in our original brief. Also see respondent's brief in *Com.* v. *Pan American Life Ins. Co.*, No. 264, p. 19, for a logical discussion of the correctness of this decision.

This Court has held repeatedly that reenactment of a statute by the Congress without change must be taken as approval by Congress of the administrative construction and thereby to give such construction the force of law.

The Commissioner's Regulations for fourteen years provided that a life insurance company was entitled to a deduction in respect of disability reserves. During this period of time Congress reenacted the law unchanged five different times after the first enactment in 1921. The Commissioner's regulations from 1921 to 1935, therefore, must be recognized as having the force of law. If respondent's argument were sound, the Commissioner had the authority in 1935 to change his prior regulations so as to deny a deduction in respect of disability reserves, a deduction which his prior regulations held was permissible—in effect the Commissioner had the authority to repeal the prior regulations and promulgate new ones, and *a priori*, the authority to repeal the statute itself and enact a new one. Respondent cites certain statutes as authority for the proposition that the Treasury Department has full and complete discretion to apply regulations retroactively as he sees fit. This Court in the *Reynolds Tobacco* case considered Sec. 605 of the Revenue Act of 1928, cited by the respondent (Resp. Br. 43), and held

> "that Congress intended to give to the Treasury power *to correct misinterpretations, inaccuracies, or omissions* in the regulations, and thereby to affect cases in which the taxpayer's liability had not been finally determined, unless in the judgment of the Treasury, some good reason required that such alterations operate only prospectively. The question is whether the granted power may be exercised in an instance where, by repeated reenactment of the statute, Congress has given its sanction to the existing regulation.
>
> "Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to au-

thorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

Respondent argues that Congress has gradually increased the Commissioner's power until it is complete. Instead of Congress gradually increasing the power of the Commissioner until his power is "complete," as argued by the respondent, petitioner respectfully submits that Congress gradually curtailed the Commissioner's power in respect of retroactive regulations.

For instance, Sec. 1314 of the Revenue Act of 1921 gave the Commissioner power to apply a new regulation without retroactive effect, where such new regulation *reversed* a prior regulation. This same provision was carried forward into the Revenue Acts of 1924 and 1926. (Resp. Br. 39-41.) A decided reduction in the Commissioner's power, however, was made in Sec. 605 of the Revenue Act of 1928, in that his power was restricted to regulations which ***amended*** prior regulations. Beginning in 1928, therefore, the Commissioner no longer had power to decide whether a regulation *reversing*[1] a prior regulation should have retroactive effect. Thereafter, as this Court held in construing Sec. 605, *supra,* the Commissioner's power in respect of retroactive regulations was limited to those which corrected "misinterpretations, inaccuracies, or omissions" (*Helvering* v. *Reynolds Tobacco Co., supra*); that is to which *amended* prior regulations.

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[1] To reverse means:

"To turn in opposite directions; * * * alter to the opposite in character or tendency, or change completely; * * * also to revoke, repeal or annul. * * *" (The New Century Dictionary, p. 1547.)

Whereas to amend means:

"To remove or correct faults in; changes for the better. * * *" (Id., p. 38.)

The committee report (Resp. Br. 44) shows that Congress did not in enacting Sec. 506 of the Revenue Act of 1934 (Resp. Br. 43) intend to restore to the Commissioner authority with respect to regulations which *reversed* prior regulations, but on the other hand to continue the same power relative to regulations *amending* prior regulations and also to extend the Commissioner's power to regulations which did not amend prior regulations; *i. e.*, entirely new regulations.

To summarize, the Commissioner had no statutory power in 1935 to *reverse* his prior regulations applicable to the Revenue Acts of 1928 and 1932 and prior revenue acts and to apply such revised regulations retroactively to taxable years prior to the time the reversal was made as the respondent is attempting to do in the instant case. The *Reynolds Tobacco* case was correctly decided and that decision should be held to apply to the instant case.

The construction contended for by the respondent would amount to an abdication or transfer to an administrative officer of essential legislative functions, which this Court in *Schechter* v. *U. S.*, 295 U. S. 495, 529, held that Congress could not do; and if the sections cited by the respondent be susceptible of such construction, they are unconstitutional as an unwarranted delegation of legislative power.

## CONCLUSION.

It is respectfully submitted that the decision of the Court of Claims should be reversed.

Respectfully submitted,

WALTER E. BARTON,
*Counsel for Petitioner.*

## APPENDIX.

### House Revenue Bill of 1921.

### TAXES ON INSURANCE COMPANIES.

Sec. 242. That when used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contract* (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

Sec. 243. That in lieu of the taxes imposed by sections 230 and 1000 there shall be levied, collected, and paid for the calendar year 1922 and for each taxable year thereafter upon the net income of every insurance company a tax as follows:

(1) In the case of a domestic insurance company, 12½ per centum of its net income;

(2) In the case of a foreign insurance company, 12½ per centum of its net income from sources within the United States.

Sec. 244. (a) That in the case of an insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) The term "reserve funds required by law" includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

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* The word was pluralized in the bill as finally passed.

Sec. 245 (a). That in the case of an insurance company the term "net income" means the gross income less—

(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title;

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

(3) The amount of dividends included in the gross income;

(4) In the case of life insurance companies, an amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract;

(5) Investment expenses paid during the taxable year: *Provided,* That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the

property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property;

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence;

(8) All interest paid within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities, the interest upon which is wholly exempt from taxation under this title as income to the taxpayer.

**Regulations.**

Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act) prior to amendment, as hereinafter referred to, were the same and read as follows:

"Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

"(1) Interest which is exempted in the case of other taxpayers by section 22 (b) (4) and articles 84-87;* and

"(2) Four per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per cent shall be substituted for 4 per cent. The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

* 88 in Art. 971 of Reg. 74.

**"In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies.*** The deduction in respect of such reserve funds (not required by law) is 3¾ per cent of the mean of such reserve funds held at the beginning and end of the taxable year. Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual Statement. Generally speaking, the following will be considered reserves as contemplated by the law: *Items 7-11 of the liability page of the annual statement for life insurance companies, and items 16-19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business.*** If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered." (Italics ours.)

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*This provision has been incorporated in all regulations from 1921 to date.

**This provision was in the regulations from 1921 until Feb. 11, 1935 and not eliminated from the regulations applicable to the Acts of 1921, 1924, 1926, 1928 and 1932 until Dec. 15, 1935.

In all material respects, Art. 681 of Reg. 62 (1921 Act), Art. 681 of Reg. 65 (1924 Act) and Art. 681 of Reg. 69 (1926 Act) prior to amendment, as hereinafter referred to, were the same as Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act), *supra*.

On February 11, 1935, Art. 203 (a) (2)-1 of Reg. 86 (1934 Act) was promulgated, which reads as follows:

> "In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; annual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.
>
> "In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is per-

mitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

**"In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. The deduction in respect of such reserve funds (not required by law) is 3¾ per cent of the mean of such reserve funds held at the beginning and end of the taxable year."**

Later the Commissioner promulgated Art. 203 (a) (2)-1 of Reg. 94 (1936 Act) and Art. 203 (a) (2)-1 of Reg. 101 (1938 Act), which articles were exactly the same as Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), *supra*. It will be observed that Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), 94 (1936 Act) and 101 (1938 Act) omitted the language which we italicized of Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act), and which was also contained in Art. 681 of Reg. 62 (1921 Act), Art. 681 of Reg. 65 (1924 Act) and Art. 681 of Reg. 69 (1926 Act), *supra*. On December 18, 1935 the last-mentioned Regulations, namely, Art. 681 of Reg. 62 (1921 Act), 65 (1924 Act) and 69 (1926 Act), and Art. 971 of Reg. 74 (1928 Act) and Art. 971 of Reg. 77 (1932 Act) were amended by T. D. 4615 to read in all material respects the same as Art. 203 (a) (2)-1 of Reg. 86 (1934 Act), 94 (1936 Act) and 101 (1938 Act), omitting therefrom the italicized language referred to which was contained in said Regulations prior to amendment by T. D. 4615.

Attention is called to the fact that the provision regarding "reserve funds not required by law" as shown in boldfaced type above has been incorporated in all of the original and amended regulations from 1921 to the present time.

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# In the Supreme Court of the United States

OCTOBER TERM, 1939

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No. 417

NEW WORLD LIFE INSURANCE COMPANY, PETITIONER

*v.*

THE UNITED STATES

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*ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

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## BRIEF FOR THE UNITED STATES IN OPPOSITION

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### OPINION BELOW

The opinion of the court below (R. 32–60) is reported in 26 F. Supp. 444.

### JURISDICTION

The judgment of the court below was entered on March 6, 1939 (R. 60). A motion for a new trial was overruled on May 29, 1939 (R. 60). The petition for a writ of certiorari was filed on September 25, 1939, the time for filing having been extended by order of this Court (R. 70). The jurisdiction of this Court is invoked under Section 3 (b) of the

Act of February 13, 1925, as amended by the Act of May 22, 1939.

### QUESTIONS PRESENTED

1. Whether, under Section 203 (a) (5) of the Revenue Acts of 1928 and 1932, a life insurance company may, for federal income tax purposes, allocate to and deduct as investment expenses, without limitation, a portion of the salaries paid to its officers for services performed generally in all departments of its business.

2. Whether, under Section 203 (a) (2) of the Revenue Acts of 1928 and 1932, a life insurance company is entitled, for federal income tax purposes, to a deduction on account of reserve funds held by it to cover liability under outstanding policies of health and accident insurance.

### STATUTES INVOLVED

The pertinent portions of the applicable statutes are set out in the Appendix.

### STATEMENT

The special findings of fact of the court below (R. 17–32) may be summarized as follows:

Petitioner is a stock life insurance company, organized under the laws of the State of Washington, with its principal offices in Seattle (R. 17). During the years 1929 to 1932, inclusive, and prior thereto, petitioner was engaged in the business of issuing and selling life insurance in Washington and other states (R. 17).

In its tax returns for those years petitioner deducted from gross income as investment expenses certain percentages of the salaries which it paid to its president, treasurer, general counsel, and cashiers, the total amounts of such deductions being as follows: For 1929, $17,149.92; for 1930, $21,492.21; for 1931, $24,124.61; and for 1932, $26,634.31 (R. 18–22). The portions of the salaries thus deducted were charged by petitioner to its investment expenses, pursuant to a resolution adopted by its board of directors in 1929 (R. 24–25). The salaries of these officers and cashiers were for all services rendered by them, and their services related to matters in all departments of petitioner's business, *i. e.*, in both the investment and underwriting departments (R. 24).

In his final determination of petitioner's tax liability, the Commissioner of Internal Revenue allowed deductions for expenses incurred directly in the investment department, as follows: For 1929, $38,730.29; for 1930, $41,197.85; for 1931, $40,818.53; and for 1932, $36,867.70; and disallowed the aforementioned portions of the salaries of petitioner's general officers which it had assigned to investment expenses (R. 18–22). One-fourth of one per centum of the mean of petitioner's invested assets for these years is as follows: For 1929, $21,465.27; for 1930, $23,243.10; for 1931, $24,513.65; and for 1932, $24,872.81 (R. 19–23).

Some of petitioner's life insurance policies, all of which are on the level premium plan, contained

additional provisions for health and accident insurance (R. 17). The average mean of the reserve funds held by petitioner during the years involved herein for the fulfillment of its life insurance contracts was approximately $7,500,000, and for fulfillment of its health and accident policies was approximately $195,000 (R. 17–18).

Petitioner issues health and accident insurance only in a combined policy of life, health, and accident insurance, *i. e.*, by the insertion of an additional sheet (R. 66) covering health and accident insurance in a standard form of life policy (R. 26). A separate premium is charged for the health and accident insurance, which may be discontinued without affecting the life insurance (R. 26). The reserves held on account of health and accident insurance do not enter into the amount of the reserves held on account of life insurance covered by the policy, nor do they enter into the surrender, cash, or loan values of the policies (R. 26, 61–68).

In its tax returns petitioner took deductions on account of reserves held by it to meet liabilities arising under policies of health and accident insurance (R. 18–23). In his final determination the Commissioner treated these deductions as follows: For 1929 and 1930 he allowed deductions as taken by petitioner. (The Government thinks these deductions were erroneous, but any recovery is now barred.) For 1931 and 1932 he disallowed deductions in respect to reserves held on account of dis-

abled lives, and allowed deductions on account of active lives (R. 18–23).

Timely claims for refund were filed by petitioner for all the claims and years involved, and were rejected by the Commissioner (R. 30–32).

The court below held that the petitioner was not entitled to recover and dismissed the petition (R. 60).

## ARGUMENT

### I

Section 203 (a) (5) of the Revenue Acts of 1928 and 1932 provides that life-insurance companies may deduct—

> Investment expenses paid during the taxable year: *Provided,* That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year. * * *

Petitioner charged to its investment expenses portions of the salaries which it paid to its president, treasurer, general counsel, and cashiers, all of whom were employed generally in all departments of its business. It claims the right to deduct such amounts as "investment expenses," and not as "general expenses * * * in part assigned to or included in the investment expenses." It has been allowed deductions for direct investment ex-

penses in excess of the one-fourth of 1 per centum limitation provided by the statute where general expenses are in part assigned to investment expenses. The Commissioner of Internal Revenue rejected petitioner's claims for deductions on account of the allocated portions of the salaries,[1] and the court below upheld his determination.

The decision below is plainly correct. The term "general expenses" clearly was used in contradistinction to expenses incurred directly in the investment department, and salaries of the general officers are certainly general expenses. Petitioner's contention leads to the conclusion that whenever a general expense is assigned in part to investment expenses it thereupon becomes a direct investment expense. Since direct investment expenses are deductible without limitation, the conclusion renders meaningless the limitation provision of the statute.

The interpretation given the provision below is supported by the general scheme of the Revenue Acts for the taxation of life-insurance companies, and by the reason for the particular provision in question. Only the investment income of life-insurance companies is taxed, and not their income from premiums. Accordingly, deduc-

[1] Instead of allowing petitioner's claims and then invoking the one-fourth of 1 per centum limitation because general expenses were in part assigned to investment expenses, the Commissioner followed the more liberal course of disallowing the claims entirely. Petitioner was thereby given the benefit of allowance in full of the undisputed investment expenses.

tion is allowed only of investment expenses. And since, by general practice, premiums are so adjusted as to cover general operating expenses, general expenses are not allowed to be deducted except as assigned to investment expenses, and then only to bring the deduction for such expenses up to the statutory maximum. (See R. 35–45.)

The decision below overrules the earlier decision of the court below in *Sun Life Ins. Co.* v. *United States*, 81 C. Cls. 892, and is in conflict with the decisions of the Board of Tax Appeals in *Volunteer State Life Ins. Co.* v. *Commissioner*, 27 B. T. A. 1149, 35 B. T. A. 491, now pending on appeal in the Circuit Court of Appeals for the Sixth Circuit. In those decisions the considerations just discussed were not considered, and the court accordingly refused to follow them (R. 45). The present decision is not contended to be and is not in conflict with any decision of any federal court of appeals.

## II

Section 203 (a) (2) of the Revenue Acts of 1928 and 1932 (*infra*, pp. 11–12) provides that a life insurance company may deduct an amount equal to 4 per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year. Petitioner contends that under this provision it is entitled to deductions on account of reserve funds held by it to cover health and accident insurance, and not merely to deductions on account of reserves held to cover life insurance.

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The decision below to the contrary follows the decisions of this Court in *Helvering* v. *Illinois Ins. Co.*, 299 U. S. 88, and *Helvering* v. *Inter-Mountain Insurance Co.*, 294 U. S. 686. In the former case the Court held that Section 203 (a) (2) did not permit deductions on account of reserves held to cover payments under a "survivorship investment" feature of 20-payment life policies. It said (299 U. S. at 90):

> The phrase "required by law" includes only reserves that directly pertain to life insurance. Other reserves, even though required by state statutes regulatory of the business authorized to be carried on by life insurance companies, are not included. * * *

See also *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109, 119; *United States* v. *Boston Insurance Co.*, 269 U. S. 197. The reserves for health and accident insurance on account of which petitioner claims deductions are not only not held on account of life insurance, but are not of the same character as technical life insurance reserves.[2]

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[2] They are required by the laws of Washington (*infra*, p. 16) to be computed upon the net premium basis, and the mortality element is incidental and does not involve the element of life risk as in the case of life insurance. In a life policy the mortality element requires the building up of a reserve sufficient to meet the policy obligations at maturity, that is, at death, while in health and accident insurance death, instead of maturing the liability, terminates the risk. Moreover, in health and accident insurance the contingency for which reserves are held may never happen.

Petitioner points out (pp. 19–20) that the Treasury Regulations prior to T. D. 4615, XIV–2 Cum. Bull. 310 (1935), allowed reserve deductions of the character involved in this case, and contends that the decision below, in refusing to follow the pre-1935 Regulations, is in conflict with *Helvering* v. *Reynolds Co.*, 306 U. S. 110. That decision did not purport to overrule or modify any of the principles established by this Court on the force and effect of Treasury Regulations. The court below was correct in stating (R. 59) that the earlier Regulations were not in harmony with the decisions of this Court, and it is well settled that changes in the Regulations are authorized in such a situation. See *Manhattan Co.* v. *Commissioner*, 297 U. S. 129, 134–135; *Morrissey* v. *Commissioner*, 296 U. S. 344, 355. Reenactment of a statutory provision does not validate an otherwise invalid regulation. *Koshland* v. *Helvering*, 298 U. S. 441, 446–447; *Biddle* v. *Commissioner*, 302 U. S. 573, 582. Petitioner also points out (p. 28) that the decision below is in conflict with certain decisions of the Board of Tax Appeals,[3] but does not contend that it is in conflict with any decision of any court.

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[3] *Equitable Life Assurance Society* v. *Commissioner*, 33 B. T. A. 708; *Monarch Life Ins. Co.* v. *Commissioner*, 38 B. T. A. 716, now pending in the Circuit Court of Appeals for the First Circuit; *Pan-American Life Ins. Co.* v. *Commissioner*, 38 B. T. A. 1430, now pending in the Fifth Circuit; *Oregon Mutual Life Ins. Co.* v. *Commissioner* (memorandum opinion, rendered January 4, 1939), now pending in the Ninth Circuit.

CONCLUSION

The decision below follows the decisions of this Court and is not in conflict with any decision of any circuit court of appeals. The questions involved are of no more general importance than most tax questions, which necessarily affect a large class of taxpayers. It is therefore respectfully submitted that the petition should be denied.

ROBERT H. JACKSON,
*Solicitor General.*
SAMUEL O. CLARK, JR.,
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NOVEMBER 1939.

## APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 201. TAX ON LIFE INSURANCE COMPANIES.

(*a*) *Definition.*—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

* * * * *

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(*a*) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

(1) TAX-FREE INTEREST.—The amount of interest received during the taxable year which under section 22 (b) is exempt from taxation under this title;

(2) RESERVE FUNDS.—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life

and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

(5) INVESTMENT EXPENSES.—Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year; * * *.

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 203. NET INCOME OF LIFE-INSURANCE COMPANIES.

(a) GENERAL RULE.—In the case of a life-insurance company, the term "net income" means the gross income less—

* * * * *

(2) RESERVE FUNDS.—An amount equal to 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ per centum shall be substituted for 4 per centum. Life-insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, shall be allowed, in addition to the above, a deduction of 3¾ per centum of the mean of such reserve funds

(not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

Washington General Statutes (Pierce's Code, 1929, Vol. 1):

SEC. 2990. *Insurance Classified.*—Sec. 83. All business in this state is hereby classified as follows:

(1) Fire and marine insurance, upon buildings and other property against loss or damage by fire, lightning, wind storms, cyclones, tornadoes, hail, or earthquakes, water from the breakage or leakage of sprinklers, pumps, or other apparatus erected for extinguishing fires, and water pipes; and against accidental injury to such sprinklers, pumps, or other apparatus; and against loss or damage arising from the prevention or suspension of rent or use and occupation of any building, plant or manufacturing establishment due to the hazard or peril insured against; and upon vessels, boats, cargoes, goods, merchandise, freight and other property against loss or damage by the risks of lake, river, canal and inland transportation and navigation, including insurance upon automobiles, whether stationary or being operated under their own power, and reinsurance of any risks taken in this class; but not upon ocean marine risks, and other casualty insurance risks.

(2) Marine insurance, being ocean and inland risks, transportation and automobiles, but not including any other casualty insurance as hereinafter provided.

(3) Life insurance, being [including] endowments and annuities, but not including health, or accident or sickness insurance or any other casualty insurance as hereinafter provided.

(4) Accident insurance, and either sickness or health insurance being insurance against injury, disablement, or death resulting from travel or general accident, and against disablement resulting from sickness; and every insurance appertaining thereto.

* * * * *

(6) Liability insurance, being all insurance against loss or damage resulting from accident to or injury, fatal or non-fatal, suffered by an employe or other person and for which the insurer is liable.

SEC. 2991. *Insurance Permitted.*—Sec. 84. Any insurance company having the required amount of capital, or assets, when permitted by its articles of incorporation or charter, may be authorized and licensed by the commissioner to make insurance in this state under one or more of the classes prescribed in the several paragraphs in section 83 of this act, as follows:

* * * * *

Life. (3) No stock company shall make insurance in this state under class three of section 83 without having a capital stock fully paid of at least one hundred thousand dollars ($100,000.00) with a surplus of not less than fifty thousand dollars ($50,000.00), nor shall such company make insurance in this state in any other of said classes of insurance except in classes four and six; nor to make insurance in class four without having additional capital of at least fifty thousand dollars ($50,000.00); nor to make

insurance in class six without having additional capital of at least two hundred thousand dollars ($200,000.00) nor to make insurance in classes four and six without having additional capital of at least two hundred and fifty thousand dollars ($250,000.00).

SEC. 2999. *Life—Legal Reserve.*—Sec. 92. The commissioner shall annually make valuation of all outstanding policies, additions thereto, unpaid dividends, and all other obligations of every life insurance company doing business in this state; and all such valuations made by him or his authority shall be according to the standard of valuation adopted by the company: *Provided,* That in either case the standard of valuation employed shall be stated in his annual report: *Provided further,* That no such standard of valuation whether on the net level premium, preliminary term, or select and ultimate reserve basis, for policies issued after the passage of this act shall be less than that determined upon such basis according to the American Experience Table of Mortality with three and one-half per centum interest. The commissioner may vary the standard of valuation in particular cases of invalid lives and other extra hazards: *Provided,* The same is on basis of at least three and one-half per centum, value policies in groups, use approximate average for fractions of a year, and assume as accurate the valuation of the department of insurance of any other state or country, if the insurance officer of such other state or country likewise accredits the valuation made by the commissioner of this state: *Provided,* That when the preliminary term basis is used it shall not exceed one year.

The legal minimum standard for the valuation of annuities issued after January first, nineteen hundred and twelve, shall be "McClintock's Table of Mortality Among Annuitants," or the American Experience Table of Mortality, with interest at three and one-half per centum per annum, but annuities deferred ten or more years and written in connection with life or term insurance shall be valued in the same mortality table from which the consideration or premiums were computed, with interest not higher than three and one-half per centum per annum.

* * * * *

SEC. 3001. *Health—Reserve.*—Sec. 94. The commissioner shall annually make valuations of all outstanding policies of every company insuring against disablement by sickness, on the net premium basis, according to the "British Friendly Society Tables, eighteen hundred and eighty," or the "Manchester Unity Friendly Society Tables," eighteen hundred and ninety-three to eighteen hundred and ninety-seven, with interest at three and one-half per centum per annum. He may, in his discretion, vary the standard in particular cases, and may also require additional reserve because of hazardous occupations, impairment of the lives of the insured or insufficient net premiums. This provision shall not apply to policies insuring for not longer than one year without privileges of renewal.

U. S. GOVERNMENT PRINTING OFFICE: 1939

# In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 2

NEW WORLD LIFE INSURANCE COMPANY, PETITIONER

*v.*

THE UNITED STATES

*ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

## MOTION OF THE UNITED STATES TO DISMISS WRIT OF CERTIORARI

The Solicitor General, pursuant to Rule 7, paragraph 3 of the Rules of the Supreme Court, moves that the writ of certiorari herein be dismissed on the ground that this case is now moot, since the judgment of the court below would remain unchanged regardless of how this Court might decide the issue raised by petitioner which is now before the Court.

Petitioner instituted this suit in the Court of Claims to recover income taxes paid by it for the four-year period 1929–32. In order to simplify the discussion herein we will undertake to show first that the issue is moot as to the years 1929 and



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1930. Although the result is the same for the years 1931 and 1932, the issue is presented in somewhat different form, and we will, therefore, consider those years separately.

1. *The years 1929 and 1930.*—Petitioner's sole ground for recovery in the Court of Claims was that it had been erroneously denied, under Section 203 (a) (5) of the Revenue Act of 1928, a full deduction for that portion of its officers' salaries which it allocated to "investment expenses", and that it had therefore overpaid its taxes in that respect. That was the *sole* issue presented in its claim for refund for the years 1929 and 1930 (R. 30–31, par. 26), and that was the *sole* item of refund for those years which it sought in its bill of complaint. See Count I, par. (7) with respect to the year 1929 (R. 3),[1] and Count II, par. (7) with respect to the year 1930 (R. 6).[2]

In the Court of Claims, the Government defended on two grounds. *First,* it undertook to

---

[1] Thus it appears that petitioner's tax for the year 1929 was computed on the basis of a net income of $63,430.42, whereas petitioner contended in its pleadings before the Court of Claims that that net income should have been reduced by $17,149.92, representing investment expenses which the Commissioner had disallowed under Section 203 (a) (5) of the 1928 Act (R. 3).

[2] Similarly, for the year 1930, petitioner's tax was computed on the basis of a net income of $85,805.70, and petitioner's sole attack in its pleadings against that computation was that its net income should have been reduced by $21,492.21, representing investment expenses which the Commissioner had likewise disallowed (R. 6).

support the Commissioner's interpretation of Section 203 (a) (5), and contended that the Commissioner correctly disallowed the disputed investment expenses. *Second,* as an affirmative defense, it argued alternatively that even if those investment expenses should have been deducted, the taxpayer had nevertheless *underpaid* its taxes with respect to a wholly different item by taking deductions on account of its reserve funds for health and accident insurance. It was too late for the Government to attempt to assess any deficiency with respect to that second item, for the statute of limitations had already run. But it was still open to the Government to show, defensively, that the taxpayer had in fact underpaid its taxes with respect to that item, in order to offset any possible overpayment by the taxpayer on the investment expense item. *Lewis* v. *Reynolds,* 284 U. S. 281.

The Court of Claims ruled against the taxpayer on the investment expense issue, holding that the Commissioner correctly disallowed the disputed deduction. In so holding the Court of Claims completely disposed of the only item with respect to which the taxpayer was seeking any refund for the years 1929 and 1930. It was thus wholly unnecessary for the court below to proceed to consider whether, had it ruled the other way on the investment expense issue, any resulting refund to the taxpayer would be offset by its underpayment of taxes on account of its health and accident reserve deductions. Nevertheless, the Court of

Claims did go on to consider the Government's alternative defense, and decided that issue in the Government's favor. However, it is plain that it was immaterial whether that second issue was decided for or against the Government. The court had ruled against the taxpayer on the investment expense issue, thus making it impossible for the taxpayer to obtain any refund for the years 1929 and 1930, regardless of the soundness of the Government's alternative affirmative defense.

The taxpayer's petition for certiorari presented both the investment expense and the reserve questions, without disclosing that the second question was simply a defensive issue that would become moot once the first question were decided against it. The Government's brief in opposition simply pointed out that both issues were correctly decided, that there were no conflicts and that the petition should therefore be denied. This Court denied certiorari, 308 U. S. 612. Thereafter, the taxpayer called the Court's attention to a subsequent decision of the Circuit Court of Appeals for the Fifth Circuit which ruled contrary to the Court of Claims on the reserve issue, in a case where that issue was squarely presented (*Commissioner* v. *Pan-American Life Ins. Co.*, 111 F. (2d) 366). This Court thereupon vacated its order denying certiorari, and granted certiorari "limited to the second question presented" (R. 70), *i. e.*, the reserve issue. There was still no conflict as to the wholly separate investment expense issue, and

there was therefore still no occasion to review the action of the Court of Claims thereon.

Thus, this case is now in this posture: the only ground upon which petitioner could be entitled to a refund below (the investment expense issue) was decided against it by the Court of Claims, and this Court has denied further review. But the Court has granted certiorari on the second issue, the determination of which can in no way affect the judgment entered by the court below. Thus, the only question in this case before the Court is moot.[3]

2. *The years 1931 and 1932.*—Although several additional elements are present for the years 1931 and 1932, the ultimate situation is precisely the same as that presented for the two preceding years, namely, that the judgment entered by the Court of Claims can in no way be affected by the health and accident reserve issue and that the issue is therefore moot.

Petitioner's bill of complaint sought refund for the years 1931 and 1932 on account of alleged overpayment of taxes with respect to the deduction for investment expense as well as two other items.

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[3] The Government has petitioned for certiorari in the *Pan-American* case, No. 264, present Term, relying largely upon the conflict with the decision below in the instant case. At the time that petition was prepared, we had not realized that the issue in the instant case was moot. Although the issue in the *Pan-American* case is not moot, the Court will undoubtedly wish to consider whether there will remain any basis for certiorari in that case, if it grants our motion to dismiss in the instant case.

See Count III, par. (8) with respect to the year 1931 (R. 9–10),[4] and Count IV, par. (8) with respect to the year 1932 (R. 13–14).[5]

However, in his final determination for the years 1931 and 1932, the Commissioner conceded the correctness of the taxpayer's position as to the other two items.[6] But no refund was forthcoming to petitioner with respect to the two additional items for either of the years 1931 and 1932, because of certain uncontested offsets which completely absorbed those additional items.[7]

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[4] Petitioner sought refund with respect to three items for the year 1931: First, investment expense deduction of $24,124.61; second, depreciation on farm buildings in the amount of $3,675.26; and third, so-called nontaxable income in the amount of $2,000 (R. 9). As pointed out in the text, however, the Commissioner conceded the correctness of the taxpayer's position with respect to the second and third items (R. 21, Finding 9 (d)), thus leaving in controversy only the investment expense issue.

[5] Similarly, petitioner sought refund with respect to three items for the year 1932: First, investment expense deduction of $26,634.31; second, depreciation on farm buildings in the amount of $5,272.06; and third, interest in the amount of $1,638.30 (R. 13). And, as in the case of the year 1931, the Commissioner likewise conceded the correctness of the taxpayer's position with respect to the second and third items for the year 1932 (R. 23, Finding 12 (d)), thus leaving in controversy only the investment expense issue for the year 1932.

[6] See footnotes 4 and 5, *supra*.

[7] For the year 1931 the Commissioner disallowed certain deductions aggregating $12,582.62, of which petitioner contested only $4,937.58 (see Finding 9 (b), at R. 21), thus leaving an undisputed correction in favor of the Government in the amount of $7,645.04. But that amount exceeds

The situation with respect to the years 1931 and 1932 is, therefore, as follows: Petitioner sought refund with respect to its investment expenses and two other items. The other two items for each of the years have been eliminated from the case as a result of concessions by each side. There remains, therefore, simply a suit for refund with respect to the investment expense issue—a situation identical with that for the two earlier years, 1929 and 1930. And the reserve issue was likewise raised by the Government simply as an affirmative defense for the years 1931 and 1932 as it had been for the two earlier years.

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Thus, the reserve deduction issue was in this case as to all four years solely as a defensive issue raised by the Government, and completely disappeared from the case once the investment expense

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the two items which the Commissioner conceded in favor of the taxpayer (see footnote 4, *supra*), with the consequence that no refund was due to petitioner as a result of the Commissioner's concession.

Similarly, for the year 1932 the Commissioner disallowed certain deductions aggregating $16,917.13, of which petitioner contested only $4,920.24 (see Finding 12 (b), at R. 22–23), thus leaving an undisputed correction in favor of the Government in the amount of $11,996.89. And, as in the case of the year 1931, that amount exceeds the two items which the Commissioner conceded in favor of the taxpayer (see footnote 5, *supra*), thus eliminating any possibility of a refund to petitioner as a result of the Commissioner's concession.

issue was decided in the Government's favor. The decision of the court below on the investment expense issue was plainly correct, there was no conflict on that question, and this Court properly refused to grant certiorari thereon. And since the reserve issue was simply attached to the investment expense issue as an additional defense in the event that the taxpayer should prevail on the investment expense issue, the elimination of the investment expense issue from this case automatically eliminated the reserve issue, thereby rendering it moot. We, therefore, respectfully submit that since the reserve issue is moot, the petition should be dismissed, since it has long been settled that the Court will not decide cases where it cannot grant any relief. See, *e. g., Tennessee* v. *Condon,* 189 U. S. 64; *American Book Co.* v. *Kansas,* 193 U. S. 49; *Furness, Withy & Co.* v. *Yang-Tsze Ins. Ass'n,* 242 U. S. 430.

FRANCIS BIDDLE,
*Solicitor General.*

SEPTEMBER 1940.

U. S. GOVERNMENT PRINTING OFFICE: 1940

# In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 2

NEW WORLD LIFE INSURANCE COMPANY, PETITIONER

*v.*

THE UNITED STATES

*ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

## MEMORANDUM FOR THE UNITED STATES SUPPLEMENTAL TO MOTION TO DISMISS

1. The taxpayer has filed a brief in opposition to our motion to dismiss in which it concedes (p. 2) that the reserve question was raised in this case by the Government solely as a defensive issue, and that no judgment was entered in the Government's favor on account of that issue. The taxpayer does not challenge the Government's assertion that the judgment below would remain unaffected regardless of how this Court might decide the reserve issue. Petitioner simply states that the same issue is presented in a case involving other tax years pending in the Court of Claims and that it would



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be spared the burden of litigating that case if this Court were to decide the issue here. And it states further that the determination of the issue is important to other life-insurance companies (pp. 2–3). However, it is clear that the Court will not render advisory opinions regardless of the importance of the question or of convenience to the parties.

2. In apparent recognition of the moot character of the issue, petitioner has attempted by an unusual maneuver to impart vitality to this case. Recognizing that the reserve issue was raised only defensively by the Government and that it could not have been raised otherwise since the statute of limitations had run against the Government, petitioner now, for the first time, attempts to waive the statute of limitations and consents to the entry of judgment in favor of the United States to the extent of Fifty Dollars. The short answer to petitioner's position is that the Government did not seek below nor does it seek in this Court any affirmative judgment against petitioner on account of the reserve issue. We respectfully decline to take advantage of petitioner's limited generosity. Indeed, in view of the fact that the United States itself has not petitioned for certiorari in this case, an affirmative judgment probably could not be entered in its favor on this issue. Cf. *Le Tulle* v. *Scofield*, 308 U. S. 415. 421–422.

3. Petitioner finally requests the Court to reverse the judgment below, rather than to dismiss the writ,

if our motion is granted. We respectfully submit that such procedure would be wholly unwarranted. Petitioner in the court below sought refund with respect to investment expense deductions, and the Government raised the reserve issue solely as a defensive issue. The court below denied recovery on the investment expense issue and entered judgment accordingly. That judgment is correct and should not be reversed.

The decisions cited by petitioner (pp. 4–5) deal in general with cases where the entire controversy has become moot subsequent to the decision below, and in disposing of the matter this Court quite naturally ordered a reversal of the judgment below since it would not have been responsive to existing facts had it been permitted to stand. Here, on the other hand, the judgment of the Court of Claims is entirely correct: it dismisses the taxpayer's petition because no refund is due to the taxpayer. That judgment is responsive to the facts as well as the pleadings and should not be reversed. The proper procedure here is to dismiss the writ.

Respectfully submitted.

FRANCIS BIDDLE,
*Solicitor General.*

OCTOBER 1940.

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# In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 2

NEW WORLD LIFE INSURANCE COMPANY, PETITIONER

*v.*

THE UNITED STATES

*ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS*

## BRIEF FOR THE UNITED STATES

### OPINION BELOW

The opinion of the court below (R. 32–60) is reported in 26 F. Supp. 444.

### JURISDICTION

The judgment of the court below was entered on March 6, 1939. (R. 60.) A motion for a new trial was overruled on May 29, 1939. (R. 60.) The petition for a writ of certiorari was filed on September 25, 1939, the time for filing having been extended by order of this Court. (R. 70.) The petition for a writ of certiorari was denied Novem-

ber 22, 1939. (R. 70.) Petitioner's time for filing a petition for a rehearing on its petition for a writ of certiorari was extended until March 15, 1940, by an order entered on December 18, 1939. The petition for rehearing was filed on March 4, 1940. On May 20, 1940, the Court entered an order granting the petition for a writ of certiorari, limited to the second question presented thereby, and vacated the order denying certiorari entered on November 22, 1939. (R. 70.) On September 21, 1940, respondent filed a motion to dismiss the writ of certiorari. This motion was denied October 14, 1940. The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

## QUESTIONS PRESENTED

1. Whether the writ of certiorari in this case should be dismissed.

2. Whether a life insurance company is entitled to a deduction under Section 203 (a) (2) of the Revenue Acts of 1928 and 1932 on account of reserve funds held by it with respect to health and accident insurance which it had issued in conjunction with its life insurance.

## STATUTES AND REGULATIONS INVOLVED

The pertinent portions of the applicable statutes and Treasury Regulations are set forth in the Appendix, *infra*, pp. 49–61.

STATEMENT

This suit was instituted by the petitioner to recover income taxes with respect to the calendar years 1929–1932, inclusive. The sole item for which petitioner sought refund related to the propriety of certain deductions for investment expenses.[1] That issue was decided against petitioner and this Court has refused to grant certiorari to review it. However, in defending this suit, the Government contended in the alternative that even if petitioner were otherwise entitled to a refund with respect to its investment expenses such refund could not be had in this case because petitioner had underpaid its taxes with respect to a wholly different item during those years, namely, that it had improperly taken deductions on account of its reserves for health and accident insurance.

The decision of the Court of Claims in the Government's favor on the investment expense issue made it unnecessary for the court to consider also the affirmative defense based on the reserve deduction. The court nevertheless did undertake to consider the reserve issue as well, and decided that issue for the Government. The writ issued by this Court was limited to the reserve question, and the

[1] Taxpayer's complaint originally sought refund with respect to two other items for the years 1931 and 1932 (R. 9, 13), but those items were eliminated from the case as a result of certain concessions made by each side (see Finding 9 (d), R. 21; Finding 12 (d), R. 23).

facts found by the court below (R. 17–32), relating to that question may be summarized as follows:

The taxpayer is a stock life insurance company organized under the laws of the State of Washington, and during the years 1929 to 1932, inclusive, and prior thereto, was engaged in the business of issuing and selling life insurance in Washington and other states of the United States on the level-premium plan. (R. 17.) Some of its life insurance policies contained additional provisions of total and permanent disability benefits—that is, health and accident insurance. (R. 17.) The mean of the reserve funds held by the taxpayer for the fulfillment of its life insurance contracts constituted an average of approximately $7,500,000, and of its health and accident policies an average of approximately $195,000 for the years involved herein. (R. 17–18.) It issues separate policies of life insurance, but its health and accident insurance is issued only in a combined policy of life, health and accident insurance. It sells no other kind of insurance. (R. 18.)

A sample policy containing the additional provisions for health and accident insurance is reproduced in the record. (R. 61–67.) Page 6 thereof (R. 66) contains the entire contract in respect to health and accident insurance. If that page were removed, the remainder of the policy would be the usual complete form of a life insurance policy only. The premiums for the health and accident insur-

ance are shown separately on page 6 of the sample policy (R. 66), and the total premiums shown on the face of the policy (R. 61) constitute the premium paid for the life insurance, the disability insurance, and the accident insurance (R. 26, 66). The premium paid for the life insurance constitutes the amount shown on the face of the policy (R. 61) less the premiums charged for disability and accident insurance shown on page 6 of the policy (R. 66). The policyholder may discontinue the disability and/or accident insurance without affecting the life insurance, and without affecting the life insurance premium. (R. 26.) The disability and accident benefits are not included in any paid-up term insurance, or other paid-up benefits granted upon the surrender or lapse of the policy; nor does any reserve held on account of the disability and accident insurance enter into the amount of the reserve held on account of the life insurance covered by the policy, or the surrender, cash, or loan value shown in the "Table of Loan and Non-forfeiture Values." (R. 26, 64.)

The taxpayer issues its life insurance contracts, as well as its contracts for disability insurance, on what is commonly known as the level-premium plan. (R. 27.) It creates and maintains a reserve out of the premiums received for the life insurance coverage and also creates and maintains a separate reserve out of the premiums received for the total and permanent disability benefits coverage.

(R. 27.) In respect of any policy in force which also provided for disability and/or accidental death benefits, the taxpayer at all times set up and maintained a life reserve in the same manner as if the policy had been issued without such disability and/or accidental death provisions. (R. 27.) Its outstanding assurance obligations applicable to life insurance were valued upon the basis of the American Experience Table of Mortality, with interest at 3½ percent, as required by the laws of the states in which it did business, and it maintained reserves therefor as thus calculated. (R. 27.) It deducted the statutory percentage of the mean of such life insurance reserves for each of the years involved from gross income, and there is no controversy here with respect thereto. (R. 27.)

In respect of any combined life, health and accident insurance policies in force, in addition to its reserves with respect to the life insurance coverage, the taxpayer also set up and maintained, out of the total and permanent disability premiums, reserves with respect to the total and permanent disability benefits covered by such policies. (R. 27.) These latter reserves fall into two classes, to-wit: Reserve for Active Lives, and Reserve for Disabled Lives. (R. 28–29.) The Reserve for Active Lives is established at the time the policy is issued, and relates to outstanding disability insurance on which disability has not occurred.

(R. 29.) This reserve is computed in accordance with standard combined mortality and disability tables, with interest rates as required by the laws of the states in which the taxpayer does business. (R. 29.) If and when a person carrying disability insurance becomes totally and permanently disabled, the taxpayer transfers a certain amount of the reserve for Active Lives to the reserve for Disabled Lives. (R. 29.) The amount so transferred is calculated upon the basis of selected tables of probabilities of length of disability and expected benefits (such as Hunter's Disabled Lives Mortality Table), plus an assumed rate of interest (usually 3½ per cent compound interest). (R. 29–30.) This calculation also takes into consideration the mortality element, as well as the indefiniteness of the period during which the disability benefits must be paid, since the disability payments cease upon the death of the disabled person, or upon the discontinuance of his disability. (R. 30.)

In its tax returns for the years involved, the taxpayer took deductions under Section 203 (a) (2) on account of the reserves held by it for Total and Permanent Disability Benefits arising under the disability provisions of its combined life, health and accident policies, both in respect to Active Lives and Disabled Lives. (R. 29–30.)

The court below ruled that no deductions should have been taken by petitioner under Section 203

(a) (2) with respect to its reserves for health and accident insurance. However, since the Government was not seeking any deficiency with respect thereto, the judgment of the Court of Claims denying petitioner a refund on account of the investment expense issue did not reflect its decision on the reserve question.

## SUMMARY OF ARGUMENT

### I

This suit was brought by petitioner in the Court of Claims to recover income taxes for the years 1929–1932, claiming that it had overpaid its taxes for those years as a result of being denied a certain deduction on account of investment expenses. The Government defended, first, on the ground that petitioner was not entitled to that deduction, and, second, that even if petitioner were entitled to that deduction, any possible refund arising therefrom would be offset by petitioner's underpayment of taxes in those years with respect to a wholly different item: namely, that petitioner had improperly taken deductions with respect to its health and accident reserves.

The Court of Claims held that petitioner was not entitled to the investment expense deduction. That holding completely disposed of the entire case before the court: it determined that petitioner was not entitled to the refund which it sought. But the Court of Claims went further and decided, secondly, that,

in any event, petitioner would not be entitled to a refund because it had in fact underpaid its taxes by taking unauthorized deductions on account of its health and accident insurance reserves.

This Court, in granting the petition for certiorari, limited the writ to the second issue. But it is plain that, since petitioner is in no event entitled to any refund, the second issue is moot at this stage of the proceedings. Nothing that this Court could decide with respect to that second issue, whether for or against the Government, could in any way affect the "no refund" judgment of the court below.

The fact that the same issue may be involved in later tax years is no reason to render a decision upon the issue here, where such decision could not possibly affect the result in this case. The existence of such a controversy with respect to later years may perhaps convert an otherwise moot case into a "case" or "controversy" in the constitutional sense and thereby justify, constitutionally, a declaratory judgment with respect thereto. But the Judicial Code has been specifically amended to remove all federal tax questions from the scope of the Declaratory Judgments Act, and thus forbids any mere declaration of rights with respect to federal taxes where "further relief" cannot be given.

Nor is the result any different by reason of the possible suggestion that a decision on the reserve issue here would be *res judicata* as to future years. The short answer is that the discussion of the Court of

Claims with respect to the reserve issue would not be *res judicata* as to later years. Moreover, it is doubtful, even if the reserve question had been squarely in issue in the court below, whether a decision on an unmixed question of law in a controversy involving one tax year would be *res judicata* in cases subsequently arising with respect to later tax years.

## II

In any event, petitioner is not entitled, under Section 203 (a) (2), to any deduction on account of its reserves for health and accident insurance.

Beginning with the Revenue Act of 1921, life insurance companies were specially classified. A life insurance company pays no taxes with respect to profits derived from the insurance business as such, *i. e.*, it is not taxable upon underwriting income or earned premiums. Nor is it taxable with respect to profits obtained upon the sale or disposition of any of its assets. Its taxable income is narrowly limited to include only "interest, dividends, and rents" (Section 202 (a) of the 1928 and 1932 Acts), sometimes referred to as investment income. And it is allowed deductions on account of expenses, etc., which relate to the production of such investment income. But in addition to the favorable treatment thus far accorded to a life insurance company, it is given an artificial deduction of unusual magnitude, namely, "An amount equal to * * * 4 [3¾ under the 1932 Act] per centum of the mean of the reserve funds required by law

and held at the beginning and end of the taxable year * * *" (Section 203 (a) (2)).

It is our contention that such unusually favorable treatment was intended to apply only to *life insurance* reserves, and not to reserves for health and accident insurance. An insurance company, other than a life insurance company, is given no such deduction on account of health and accident insurance, and there is no reason to believe that Congress intended to grant such deduction to life insurance companies. Indeed, the legislative history discloses quite the contrary.

Nor is there any sound reason for distinguishing between health and accident insurance sold separately and the same insurance when sold in conjunction with life insurance. Actuarially, there is no difference whatever. The reserves for health and accident insurance are separately computed, and are wholly distinct and independent of life insurance reserves. A separate premium is charged for the health and accident insurance. And it is customary to permit the owner of a "combined" policy to discontinue the health and accident insurance at any time without affecting in the least his contract of life insurance.

The decisions of this Court make it plain that the reserve deduction must be narrowly limited to life insurance reserves. In *Helvering* v. *Illinois Ins. Co.*, 299 U. S. 88, 90, this Court stated that "The phrase 'required by law' includes only reserves that directly pertain to life insurance.

Other reserves, even though required by state statutes regulatory of the business authorized to be carried on by life insurance companies, are not included." See also *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686.

In any event, to the extent that the reserves relate to policies where the disability has already occurred (reserves for "Disabled Lives"), the deduction is not available to petitioner. Such reserves are comparable to reserves for unsettled loss claims and are plainly not life insurance reserves.

Administrative practice under Section 203 (a) (2) has not been uniform. The early practice was to allow the deduction which petitioner now claims. But the Treasury had long been in doubt as to the correctness of that practice, and, following this Court's decisions in the *Inter-Mountain* and *Illinois Life* cases, it eliminated its earlier ruling from the regulations. Such change in regulations was certainly appropriate prospectively (*cf. Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90), and was equally valid as to pending cases since the prior regulations were not in harmony with the decisions of this Court relating to reserves (cf. *Manhattan Co.* v. *Commissioner*, 297 U. S. 129, 134–135). Therefore, since the earlier practice was not in accord with the correct construction of the statute, such a change in practice is not forbidden by *Helvering* v. *Reynolds Tobacco Co.*, 306 U. S. 110. But even

if the *Reynolds* decision be thought to be a bar, we believe it to have been incorrectly decided, and, for reasons set forth at length in the body of this brief, we ask that it be reexamined.

## ARGUMENT

### I

### THE WRIT OF CERTIORARI SHOULD BE DISMISSED, BECAUSE THIS CASE DOES NOT PRESENT ANY QUESTION THAT MAY BE REVIEWED IN THIS COURT

1. The Government renews its contention, made in the motion to dismiss, that this case presents no question that can be decided here.

This suit originated as a proceeding before the Court of Claims to recover income taxes for the years 1929–1932. After certain preliminary concessions, both by the Government and the taxpayer, the sole ground of recovery for all of those years was petitioner's claim that it had overpaid its taxes by being denied a full deduction for that portion of its officers' salaries which it allocated to "investment expenses". The Court of Claims, construing Section 203 (a) (5) of the applicable revenue acts, held that there had been no overpayment. The decision on that issue completely disposed of the only item of taxes for which petitioner sought refund. However, as an affirmative defense, the Government had undertaken to show that even if petitioner were entitled to a refund with respect to the investment expense issue, it had nevertheless

*underpaid* its taxes for the years in question by improperly taking deductions on account of its health and accident reserves. The statute of limitations had already run, so that the Treasury was without power to assess any deficiency with respect to the reserve deduction, but it was still open to the Government to show, defensively, that the petitioner had in fact underpaid its taxes and thus offset any possible overpayment by the taxpayer on the investment expense item. *Lewis* v. *Reynolds*, 284 U. S. 281.

Since the court below decided the investment expense issue in the Government's favor, it was therefore unnecessary for it to pass upon the affirmative defense. It nevertheless did consider that issue, and likewise decided that question in favor of the Government.[2]

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[2] The court below was apparently under a misapprehension that the issue was not entirely defensive, and that petitioner was in fact seeking refund with respect to the reserve issue, as well as the investment expense issue, for the years 1931 and 1932. See R. 47. The court's error lies in the fact that it misunderstood the stipulation of the parties, incorporated into the findings, to the effect that "the Commissioner disallowed" part of the reserve deduction for the years 1931 and 1932 (R. 21, 23). The court apparently thought that such "disallowance" resulted in payment of taxes by the petitioner for which it would be entitled to obtain a refund if the deduction were proper. But petitioner had paid no taxes whatever with respect to that item. The "disallowance" was merely in an audit by the Commissioner, after the statute of limitations had run on the years in question, and the disallowance therefore did not result in any payment by petitioner with respect to the reserve issue. This is made

This Court denied the petition for certiorari to the extent that petitioner sought review of the investment expense issue, but granted certiorari on the reserve issue. But since petitioner's only ground for refund was decided against it below and since this Court has denied certiorari on that question, it is clear, as well as undisputed, that no judgment for refund of any kind could be entered in petitioner's favor, regardless of how this Court might decide the reserve issue. That issue is moot at this stage of the litigation, and the writ should therefore be dismissed.

2. Petitioner's only apparent reason for urging that the issue is not moot is its assertion that the same issue is involved in later tax years, and that a decision by this Court on the issue would determine its tax liability with respect to this issue for such later years. But even assuming that the existence of the issue in later years could convert the otherwise moot issue into a "case or controversy" in the constitutional sense, any judgment entered by this Court could not affect the "no refund" judgment of the court below. If this Court should assume jurisdiction to decide the reserve issue, it

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abundantly clear by Exhibit B to the stipulation of facts which the Court of Claims adopted by reference in its findings (R. 23), but which was omitted from the printed record in this Court by agreement of the parties (R. 69). However, Exhibit B is properly before this Court, and clearly shows that petitioner would not in any circumstances be entitled to a refund on account of the reserve issue. We do not understand petitioner to assert the contrary.

could at most enter a declaratory judgment. But Congress has specifically withdrawn from the courts the power to enter declaratory judgments in federal tax cases. Section 405 of the Revenue Act of 1935 (c. 829, 49 Stat. 1014), carefully amended the Declaratory Judgments Act to remove from its scope controversies with respect to federal taxes. Section 405 provides as follows:

> SEC. 405. DECLARATORY JUDGMENTS AS TO TAXES.
>
> (a) Paragraph (1) of section 274D of the Judicial Code (Public, Numbered 343, Seventy-third Congress) is amended by adding after the words "actual controversy" the following: "(except with respect to Federal taxes)".

And Section 274D (1) of the Judicial Code, as amended by the foregoing provisions, now reads as follows:

> In cases of actual controversy (except with respect to Federal taxes) the courts of the United States shall have power upon petition, declaration, complaint, or other appropriate pleadings to declare rights and other legal relations of any interested party petitioning for such declaration, whether or not further relief is or could be prayed, and such declaration shall have the force and effect of a final judgment or decree and be reviewable as such.

In essence, since petitioner could not be entitled to "further relief", it is asking the Court to "de-

clare rights" within the meaning of the foregoing provisions. Yet the amendment to those provisions has made it plain that the validity of federal taxes is to be determined only in cases where they are actually involved and where a judgment affecting specific liability with respect thereto may be entered in response to the pleadings.

3. Moreover, even apart from the statutory provisions relating to declaratory judgments, petitioner has not presented an issue which this Court should decide. In *California* v. *San Pablo &c. Railroad*, 149 U. S. 308, the narrow issue before the Court had become moot, but counsel urged that the case be decided for they had entered into a stipulation that several other pending cases would be governed by the outcome of that case. This Court nevertheless held that since a decision on the merits could not affect the result in that case, the writ of error had to be dismissed. The Court stated (p. 314):

> The duty of this court, as of every judicial tribunal, is limited to determining rights of persons or of property, which are actually controverted in the particular case before it. When, in determining such rights, it becomes necessary to give an opinion upon a question of law, that opinion may have weight as a precedent for future decisions. But the court is not empowered to decide moot questions or abstract propositions, or to declare, for the government of future cases, principles or rules of law which can-

> not affect the result as to the thing in issue in the case before it. No stipulation of parties or counsel, whether in the case before the court or in any other case, can enlarge the power, or affect the duty, of the court in this regard.

Compare *Barker Co.* v. *Painters Union,* 281 U. S. 462; *South Spring Gold Co.* v. *Amador Gold Co.,* 145 U. S. 300. But cf. *So. Pac. Terminal Co.* v. *Int. Comm. Comm.,* 219 U. S. 498.[3]

4. Nor is the situation any different by reason of the possible suggestion that a decision on the reserve issue would be *res judicata* as to future tax years, and that the issue should therefore be decided here. The short answer to such circular reasoning is this: if the Court should dismiss the writ because the issue is moot or because of the provisions of the declaratory judgment statute, then the decision on the reserve issue would not be be *res judicata* as to future years. And if any doubt exists as to this, the order of the Court dismissing the writ, or an opinion of the Court accompanying the order, could so state.

Moreover, it is doubtful whether a decision on a pure question of law is *res judicata* between the

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[3] To be contrasted with the *So. Pac. Terminal Co.* case, however, is *United States* v. *Anchor Coal Co.,* 279 U. S. 812, where the Court, of its own motion, noted at the argument that the case had become moot by reason of expiration of the controverted order of the Interstate Commerce Commission. Counsel for both sides filed a brief relying upon the *So. Pac. Terminal Co.* decision and asking for an adjudication on the merits, but the Court nevertheless dismissed the appeal.

parties as to future tax years, not yet litigated. Suppose, for example, that the New World Life Insurance Company had actually paid taxes and sought a refund with respect to the reserve deduction; and suppose further that it had not petitioned for certiorari from an adverse decision of the Court of Claims construing the statute so as to deny the deduction. Then, if this Court should decide in a case involving another taxpayer, say the Pan-American Life Insurance Company, that the statute should be construed to permit the deduction, it would be harsh, indeed, to hold that the New World Life Insurance Company would be denied the deduction for all later years in perpetuity.[3a]

The term *res judicata* has been used loosely in tax cases. The traditional application of the doctrine of *res judicata* would forbid the reopening of a decision with respect to the tax year that had been litigated. But the doctrine has been extended in tax cases to embrace the same issue for future years not yet litigated. The general theory is

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[3a] The situation here is much stronger against the application of *res judicata* because the discussion of the Court of Claims on the reserve issue was entirely unnecessary to the decision.

A somewhat analogous situation might be presented in a case where review is sought in this Court of a decision of a state court that could be rested either upon a federal or non-federal ground. This Court normally declines to review such cases. Would the situation be different if the parties were to suggest that the federal ground might be controlling as *res judicata* in some possible future litigation that perhaps could not be rested upon a non-federal ground?

sound. Thus, if the March 1, 1913, value of property for the purpose of depreciation has been judicially established in a proceeding involving one tax year, the basic principles underlying *res judicata* would forbid relitigating that issue even as to a future year, and even though one side or the other has new evidence to offer. But those same principles should have no bearing where there is involved an unmixed question of law.[4] Cf. *United States* v. *Moser*, 266 U. S. 236, 241–242.

The absurd results that would flow from the application of the doctrine of *res judicata* to pure question of law in controversies not yet in litigation, or perhaps not yet arisen, is readily apparent from the example discussed above. And this Court has already indicated that the traditional concept of *res judicata* must give way in tax cases to a realistic view where it is sought to project the doctrine of *res judicata* to govern liability for future tax years. Cf. *Blair* v. *Commissioner*, 300 U. S. 5.

## II

### A LIFE INSURANCE COMPANY IS NOT ENTITLED TO ANY DEDUCTION UNDER SECTION 203 (A) (2) ON ACCOUNT OF RESERVES FOR HEALTH AND ACCIDENT INSURANCE

In the event that the Court should conclude that the reserve question is properly in issue here, we

[4] *Tait* v. *Western Md. Ry. Co.*, 289 U. S. 620, apparently involved issues of fact as well as law. In that case there was an unsuccessful attempt to show facts in the new proceeding that were said to be different from certain facts stipulated in the first proceeding. Pp. 625–626.

contend that the deductions taken by petitioner should have been denied.[5]

2. *Introductory.* Prior to the enactment of the Revenue Act of 1921, life insurance companies were taxed as ordinary corporations upon their full income.[6] Beginning with the 1921 Act, however, an entirely new system of taxation was inaugurated. Insurance companies were classified in three groups: (1) life insurance companies, (2) insurance companies other than life or mutual, and (3), mutual insurance companies other than life. The same classification obtains in the statutes here involved, the Revenue Acts of 1928 and 1932.[7] Under the new scheme of taxation, a life insurance company is no longer taxed upon its full income, and is accorded unusually favorable treatment as contrasted with the tax burdens imposed upon other corporations. It pays no taxes upon profits realized in carrying on the life insurance business as

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[5] The decision of the court below in this respect is in conflict with three circuit courts of appeals decisions now before this Court: *Helvering* v. *Pan American Life Insurance Co.*, No. 264; *Helvering* v. *Oregon Mutual Life Insurance Co.*, No. 564; and *Helvering* v. *Monarch Life Insurance Co.*, pending on extension of time for application for ceriorari.

[6] Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 11, 112; Revenue Act of 1913, c. 16, 38 Stat. 114, 166; Revenue Act of 1916, c. 463, 39 Stat. 756; Revenue Act of 1918, c. 18, 40 Stat. 1057.

[7] Life insurance companies are taxed under Sections 201–203 of the Revenue Acts of 1928 and 1932; insurance companies other than life or mutual are taxed under Section 204 of these acts; and mutual insurance companies other than life are taxed under Section 208. See Appendix, *infra*.

such; *i. e.*, it is not taxable upon underwriting income or on earned premiums. Moreover, it is not liable for taxes on profits derived through the sale or disposition of any of the numerous assets which it necessarily owns. Its taxable income is narrowly limited to include only "interest, dividends, and rents" (Section 202 (a) of the 1928 and 1932 Acts), sometimes referred to as investment income. In the circumstances, of course, available deductions from gross income have likewise been limited more or less to expenses, etc., which relate to investment income (Section 203 (a) of the 1928 and 1932 Acts). But in addition to those deductions, life insurance companies were given a unique deduction of unusual magnitude, namely, "An amount equal to * * * 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year * * *." Section 203 (a) (2) of the 1928 and 1932 Acts.[8]

In essence, therefore, a life insurance company not only escapes taxation on all of its income outside of interest, dividends and rents, but, even after its taxable income is reduced by deductions pertaining thereto, it is still further reduced by a large artificial deduction equal to a percentage of its re-

[8] Under the 1928 and earlier acts the deduction was subject to a certain limitation that was declared unconstitutional in *Nat'l Life Ins. Co.* v. *United States*, 277 U. S. 508, and the limitation was accordingly eliminated from the statute in the 1932 Act. The 1932 Act also reduced the percentage from 4 to 3¾.

serves.[9] The question here presented is whether, in computing that deduction, the petitioner is entitled to augment its life insurance reserves by adding thereto its reserves for health and accident (casualty) insurance which it sells in conjunction with its life insurance. We contend that the extraordinary deduction is limited to reserves pertaining to life insurance, and was not intended to embrace reserves on account of casualty insurance. Casualty insurance companies themselves are taxed under different provisions of the statute, and no such deduction is available to them. It is our position that

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[9] The new method of taxing life insurance companies was first proposed by the Association of Life Insurance Presidents in 1918, but, although approved by the Senate Finance Committee (S. Rep. No. 617, 65th Cong., 3d Sess., p. 9), was not incorporated into the Revenue Act of 1918. See also Cong. Rec., Vol. 57, Pt. I, p. 214. However, the new plan was finally adopted in the Revenue Act of 1921. The House Committee in recommending the new method of taxation stated that "The new tax would yield a larger revenue than the taxes which it is proposed to replace". H. Rep. No. 350, 67th Cong., 1st Sess., p. 14. That the committee was either misled or sadly mistaken is evidenced by the fact that the amount of taxes collected from life insurance companies under the new system has been but a small fraction of what would have been due from them without the artificial deduction on account of reserves. Thus, the Report of the Joint Committee on Internal Revenue Taxation (71st Cong.), Vol. 1, Part 6, p. 15, discloses that during the years 1921–1928 the amount actually due from life insurance companies was probably less than 20% of the taxes which would otherwise have been collectible in the absence of the artificial reserve deduction. And we are informed that in recent years the amount of income taxes paid by life insurance companies has declined even more sharply.

no such deduction should be allowed to a life insurance company merely because it conducts a casualty insurance business as an adjunct to its primary business of life insurance.

2. In determining whether petitioner's casualty reserves constitute "reserve funds required by law" of a life insurance company within the meaning of the deduction provisions in Section 203 (a) (2), it may be helpful to consider first the statutory definition of a life insurance company. Section 201 (a) of the 1928 and 1932 Acts defines a life insurance company as follows:

> (a) *Definition.*—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

The purpose of the foregoing definition was to classify as life insurance companies those whose business was predominantly life insurance. It was not necessary to define other types of insurance companies because they are sufficiently classified either as "Insurance Companies Other than Life or Mutual" (Sec. 204) or as "Mutual Insurance Companies Other than Life" (Sec. 208).

In applying the definition, it is necessary to determine the correct comparative under Section 201

(a), *i. e.*, what reserves are to be compared with the total reserves in applying the 50 per cent formula? The Government contends that since the purpose of the definition is one of classification the reserves for life insurance and annuity contracts [10] should be compared with the total reserves including the reserves for health and accident insurance.

Any other interpretation of the definition would have practically no meaning, because life insurance companies rarely, if ever, sell any insurance other than life or health and accident insurance. That the attention of Congress was called to the general practice in the insurance world is unmistakably clear from the Senate hearings on the bill which became the Revenue Act of 1921. In the testimony of Dr. T. S. Adams, the Treasury expert who explained the bill to the Committee, the following pertinent colloquy occurred between Senator McCumber and Dr. Adams: [11]

> Senator McCUMBER. Explain that 50 per cent of its total reserve funds, and why take 50 per cent instead of some other figure?
>
> Dr. ADAMS. Some companies mix with their life business accident and health in-

[10] A reserve for annuity contracts is essentially similar to a life insurance reserve. Both are computed on the basis of the same tables, and each complements the other.

[11] Hearings before the Senate Finance Committee on H. R. 8245 (67th Cong., 1st Sess.), p. 85.

> surance. It is not practicable for all companies to disassociate those businesses so that we have assumed that if this accident and health business was more than 50 per cent of their business, as measured by their reserves, it could not be treated as a life insurance company. On the other hand, if their accident and health insurance were incidental and represented less than 50 per cent of their business we treated them as a life insurance company.

Thus it is plain that in applying the 50 per cent formula in Section 201 (a) Congress did not intend health and accident reserves to be merged with life insurance reserves. Health and accident insurance was regarded as separate and distinct from life insurance, and, in determining whether a company was to be classified as a life insurance company, reserves for health and accident insurance were to be excluded.

Nor is there any practical basis for construing the statutory definition as providing for a comparison of (1) the amount of the reserves held for separate policies of life and annuity contracts plus all the reserves held for combined policies of life, health and accident insurance, with (2) the reserves held for separate policies of health and accident insurance. The health and accident (casualty) provisions of a combined policy of life, health and accident insurance are just as separate and distinct in their contractual character from the provisions relating to

life insurance as are contracts of health and accident insurance which are issued in separate policies. Whether issued in separate or combined policies, the reserves for this form of disability insurance are calculated, alike, upon the same tables of probabilities, are set up and maintained separately and apart from reserves for life insurance, and in no manner affect the reserves for life insurance, or enter therein. A net premium is charged for the disability provisions of a combined policy, as distinctly as is done when this kind of insurance is issued in a separate policy. Petitioner's position would result in treating disability insurance as life insurance if written in a combined policy, and as casualty insurance if written in a separate policy, whereas it is the same kind of insurance—that is, casualty insurance—regardless of which kind of policy is issued. This would entirely destroy tthe comparative in the case of a company which issues no separate policies of disability insurance, such as the taxpayer in this case. In the case of a company which issues separate as well as combined policies of casualty insurance, it would operate to array the reserves held on account of disability insurance issued under combined policies against reserves held for the same kind of insurance issued under separate policies, a result that Congress could hardly have intended where it sought to classify companies according to the kind of insurance issued.

We now pass to the deduction provisions in Section 203 (a) (2), which should be interpreted

against the background of the foregoing discussion. For, since the definition of a life insurance company shows that Congress was intent upon granting unusual treatment only to companies whose business was predominantly life insurance, it seems clear that Congress could not have intended the unusual reserve deduction to apply to any but life insurance (including annuity contracts) reserves.

3. Section 203 (a) (2) allows to life insurance companies a deduction of—

> An amount equal to * * * 4 [3¾ under the 1932 Act] per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year * * *.

It is our position that, in allowing such an extraordinary deduction to life insurance companies, Congress intended it to apply only to life insurance reserves.

The difference between reserves for life insurance and reserves for health and accident insurance was plainly brought out in the Senate Hearings on the 1921 bill. Senator McCumber had been under a misapprehension that health and accident insurance was to be treated the same as life insurance, and it was in a response to his inquiry that the situation was clarified (Senate Finance Committee Hearings on H. R. 8245, 67th Cong., 1st Sess., p. 85):

> Senator McCumber. If they are treated just alike I do not see any necessity of making any distinction.

> Dr. ADAMS. They are not treated just alike. There is only one deduction that goes under life insurance alone.

Any other treatment would be discriminatory in favor of life insurance companies against casualty insurance companies. No such deduction is allowable to the latter on account of health and accident reserves. It was only because of an asserted inherent difference in the nature of life insurance that life insurance companies were separately classified for tax purposes. And the mere fact that life insurance companies have been so fortunate as to persuade Congress to award them this unusual deduction on account of their life insurance reserves is no reason to believe that Congress intended to extend that deduction to casualty reserves. Indeed, since casualty insurance companies themselves are not entitled to any such deduction with respect to their casualty reserves, Congress could hardly have intended to grant such deduction to life insurance companies simply because they enjoy such unusually favorable treatment with respect to their life insurance reserves.

The decisions of this Court indicate that the reserve deduction given to life insurance companies is to be narrowly restricted to life insurance reserves. Thus, in *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, a life insurance company had issued 20-year non-participating life insurance policies to each of which were attached 19

coupons maturing annually and in each of which the company promised to pay a specified amount to the owner of the policy. The insured was given the option of leaving the coupons to accumulate interest or to be applied towards the purchase of additional insurance. Since the company was required by law to maintain reserves on account of such coupons, it sought a deduction with respect thereto. This Court denied the deduction, holding that the reserve deduction was limited strictly to life insurance reserves. The Court said (pp. 689, 690):

> In the reserves required by the laws of Utah and of the other States in which the company issues policies of the described class, there is included an amount sufficient to cover not only all elements of insurance but also the coupon liability. We are not here dealing with reserves in relation to solvency of the company. The thing to be ascertained is the meaning that Congress intended by the language "4 per centum of the mean of the reserve funds required by law." *The clause to be construed relates exclusively to life insurance companies.* It is intended to define a deduction which they are permitted to make in the calculation of the net amount to be taxed. The rule that ambiguities in statutes imposing taxes are to be resolved in favor of taxpayers does not apply. Deductions are allowed only when plainly authorized. * * *

> * * * In life insurance the reserve means the amount, accumulated by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts. * * * [Italics supplied.]

A like result was reached in *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474 (C. Cls.). Cf. *Minnesota Mutual Life Ins. Co.* v. *United States,* 66 C. Cls. 481, certiorari denied, 279 U. S. 856 (reserve for deferred dividends); *Massachusetts Mutual Life Ins. Co.* v. *United States,* 56 F. (2d) 897 (C. Cls.) (reserve for dividends left with company to accumulate interest).

Again in *Helvering* v. *Illinois Ins. Co.,* 299 U. S. 88, this Court held that reserves on account of "survivorship investment funds" growing out of 20-payment life insurance policies were not within the statute. The Court stressed the fact that the deduction is available only with respect to *life insurance* reserves (p. 90):

> The phrase "required by law" includes only reserves that directly pertain to life insurance. Other reserves, even though required by state statutes regulatory of the business authorized to be carried on by life insurance companies, are not included.* * *

Cf. *New York Ins. Co.* v. *Edwards,* 271 U. S. 109.

Moreover, the very structure of Section 203 (a) (2) shows that no deduction was to be allowed on account of such casualty insurance as is here involved. Section 203 (a) (2) provides:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) *Reserve Funds.*—An amount equal to * * * 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

The type of insurance mentioned in the long parenthetical provision is commonly known as industrial insurance. The health and accident feature in such policies is inseverable from the life insurance. It is insurance of a very specialized character. And the deduction is allowable only if the many conditions set forth are met. These specific provisions emphasize the basic pattern of the deduction: in general, only life insurance reserves may form the basis for the deduction; any other reserves to be included must be spelled out in detail.

It is clear, we submit, that both the unambiguous intention of Congress and the structure of Section 203 (a) (2) itself forbids the deduction sought by petitioner. But even if there were doubt on the issue, that doubt would have to be resolved against petitioner, for deductions are allowable only when plainly authorized. See *Helvering* v. *Inter-Mountain Life Insurance Co.*, 294 U. S. 686, 689–690; *White* v. *United States*, 305 U. S. 281, 292; *United States* v. *Stewart*, No. 13, present Term, decided November 12, 1940; *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, No. 121, present Term, decided November 12, 1940.

4. We do not understand petitioner to contend that it would be entitled to a deduction on account of reserves for health and accident insurance if it had sold the health and accident insurance separately, apart from its life insurance. Its sole contention appears to be that merely because its health and accident insurance is sold in conjunction with its life insurance it somehow or other partakes of the nature of life insurance for the purpose of the deduction.

But the mere fact that two policies are combined can be of no significance here. They are entirely separate contracts (cf. *New York Life Ins. Co.* v. *United States*, 12 F. (2d) 643 (C. C. A. 2d), certiorari denied, 273 U. S. 712), and the premium for the health and accident provisions is separately shown (R. 66). An examination of the specimen policy (R. 61–68) shows that it is a life insurance

policy complete in itself, and that the health and accident provisions are on a separate sheet (R. 66) which could readily be inserted or omitted without affecting the basic life insurance policy. The health and accident insurance may be discontinued at any time without affecting the life insurance. And the reserves held on account of the health and accident insurance are entirely independent of the life insurance. Those reserves have nothing whatever to do with the reserves on the life insurance policy itself.

The two types of insurance are just as separate and distinct as if written in separate policies. The only reason for combining them physically in a single document is that the company's practice is to sell health and accident insurance only in conjunction with life insurance. But there is nothing inherent in the two types of insurance which requires that practice, for other life insurance companies sell health and accident insurance either independently or in conjunction with life insurance. See, e. g., *Commissioner* v. *Monarch Life Insurance Co.*, 114 F. (2d) 314 (C. C. A. 1st).

To permit the deduction where the health and accident provisions are physically pasted into a life insurance policy while denying the deduction where the health and accident policy is sold in a separate document would seem to be an obvious distortion of Congressional intent.

5. It is to be observed further that petitioner's reserves on account of its health and accident insur-

ance fall into two groups: reserves for "Active Lives" and reserves for "Disabled Lives." (R. 29–30.) The former relate to outstanding policies where disability has not yet occurred, or may never occur. The latter relate to policies where disability has already occurred, and the reserve is intended to meet petitioner's liability throughout the continuance of the disability. Thus, it is apparent that the "Disabled Lives" reserve is more in the nature of a solvency reserve: the event giving rise to liability has occurred and only the extent of the liability is uncertain. Therefore, even if the Government should be wrong in contending broadly that no deductions are available on account of casualty reserves, then, in any event, no deduction should be allowed as to the reserve for "Disabled Lives." The latter reserve is comparable to reserves for liabilities for unsettled loss claims, which are plainly not *insurance* reserves. Cf. *United States* v. *Boston Insurance Co.*, 269 U. S. 197, 203, disapproving *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 350. See also *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585, 588–589; *New York Ins. Co.* v. *Edwards*, 271 U. S. 109, 117–119, 119–121.

6. The administrative practice under Section 203 (a) (2) has not been uniform. The Treasury Regulations originally provided [12] for deductions with respect to "Items 7–11 of the liability page of the annual statement for life insurance companies".

[12] See Article 681 of Regulations 62, 65, and 69, and Article 971 (2) of Regulations 74 and 77.

And reference to "Items 7–11" discloses that reserves for health and accident insurance were embraced therein.[13]

However, the Treasury Department had long been in doubt as to the correctness of that ruling, and, encouraged by this Court's decisions in the *Inter-Mountain* and *Illinois Life* cases, it eliminated that ruling in promulgating Regulations 86 under the Revenue Act of 1934. Since those were the first regulations issued under the 1934 Act, and therefore operated prospectively only,[14] it is quite clear that, at least for the year 1934 and thereafter, the Treasury Department was not bound by the earlier practice. Cf. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90.

But the tax years in this case are governed by the 1928 and 1932 Acts with respect to which Regulations 86 have no application. Regulations 74 and 77, respectively, contain the rulings applicable to the 1928 and 1932 Acts. And those regulations, as originally promulgated, set forth the earlier practice.[15] It was thus necessary to amend those regulations in order to reflect the change in practice. This was accomplished by T. D. 4615, XIV–2

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[13] See Bulletin "H," Income Tax Rulings peculiar to Insurance Companies, p. 27.

[14] Regulations 86 were formally promulgated February 11, 1935, before the first returns for the year 1934 were due (March 15, 1935). The Revenue Act of 1934 had been enacted May 10, 1934. C. 277, 48 Stat. 680.

[15] See Article 971 (2) of Regulations 74 and 77.

Cum. Bull. 312, approved December 18, 1935. Accordingly, pursuant to T. D. 4615, the regulations under the 1928 and 1932 Acts were specifically amended to eliminate the earlier ruling.

Such a "retroactive" change in the regulations is entirely proper, because the earlier regulations failed to interpret the statute correctly. They were not in harmony with the decisions of this Court which indicated that the words "reserves required by law" meant *life insurance* reserves. And it is well settled that the Treasury may change its practice, even retroactively, where its prior interpretation of the statute is erroneous. See *Manhattan Co.* v. *Commissioner,* 297 U. S. 129, 134–135; *Murphy Oil Co.* v. *Burnet,* 287 U. S. 299. Cf. *Biddle* v. *Commissioner,* 302 U. S. 573, 582; *Koshland* v. *Helvering,* 298 U. S. 441. Indeed, such change is particularly appropriate where it is induced by judicial decision. See *Morrissey* v. *Commissioner,* 296 U. S. 344, 355. Moreover, since the earlier practice was not in harmony with the correct interpretation of the statute, such a change in practice is not forbidden by *Helvering* v. *Reynolds Tobacco Co.,* 306 U. S. 110.

But even if the *Reynolds Tobacco* case is thought to be a bar, we respectfully ask that it be reconsidered. Section 1108 (a) of the Revenue Act of 1926 (c. 27, 44 Stat. 9), as amended by Section 506 of the Revenue Act of 1934, specifically provides that "The Secretary, or the Commissioner with the

approval of the Secretary, may prescribe the extent, *if any,* to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect." (Italics supplied.) These provisions plainly contemplate that a ruling or regulation under a revenue act shall affect *all* tax years governed by such act, whether or not they are prior years, *unless* the Secretary of the Treasury determines otherwise. In short, the statute gives the Secretary the power to relax the retroactive operation of ruling in his discretion. And he is presumably to exercise that discretion in the light of possible supervening equities that may have arisen in favor of the taxpayer.

The general rule contemplated by the statute is that any change in the regulations is to operate retrospectively as well as prospectively, but in order to avoid possible hardship, the Secretary is authorized to permit the prior regulation to govern up to the time of change. But the discretion was vested by Congress in the Secretary and not in the courts.

Whether the Secretary has abused his discretion in failing to provide that a new regulation operate prospectively only may be an appropriate subject for judicial review. But we believe that there is no basis for limiting the Secretary's power merely "to correct misinterpretations, inaccuracies, or omissions". (306 U. S. at 116.) Such an inter-

pretation of the Treasury's power under the plain language of the statute is without any support in the legislative history, or otherwise. We respectfully submit that the *Reynolds* decision has unduly limited the power of the Treasury to modify its regulations, and we therefore ask that it be reconsidered if it is thought to forbid the "retroactive" change in practice here.

The history of the revenue acts discloses a progressive endeavor by Congress to lodge complete discretion with the Treasury in determining whether a change in the regulations should operate prospectively only. The first statutory provisions bearing on this question appeared in the Revenue Act of 1921, c. 136, 42 Stat. 227. Section 1314 of that Act provided:

> RETROACTIVE REGULATIONS.
>
> SEC. 1314. That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

In commenting upon those provisions (referred to as Sec. 1002 in the House bill), the House Ways and Means Committee stated (H. Rep. No. 350, 67th Cong., 1st Sess., p. 15):

> Section 1002 would permit the Treasury Department to apply without retroactive effect a new regulation or Treasury decision reversing a prior regulation or Treasury decision, unless such reversal is occasioned or required by a decision of a court of competent jurisdiction.

And the Senate Finance Committee similarly remarked (S. Rep. No. 275, 67th Cong., 1st Sess., p. 32):

> Section 1314 of the proposed bill authorizes the commissioner, with the approval of the Secretary, to provide in making a regulation or Treasury decision which reverses a prior regulation or Treasury decision (if it is not immediately occasioned by a decision of a court of competent jurisdiction) that the new regulation or Treasury decision may be applied without retroactive effect.

Thus, it was clear that under the 1921 Act, any change in the regulations was to operate retrospectively as well as prospectively, unless the Treasury determined to permit the change to operate prospectively only. But where the change in regulations was occasioned by judicial decision the Treasury was to have no discretion: such change

was to affect all tax years, both before and after the change.

The next revenue act, the Revenue Act of 1924, c. 234, 43 Stat. 253, made no change in these provisions which were embodied in Section 1008 (a) of that Act. Thereafter, the same provisions were carried over as Section 1108 (a) of the Revenue Act of 1926, without any alteration. However, Section 605 of the Revenue Act of 1928, c. 852, 45 Stat. 791, amended Section 1108 (a) of the 1926 Act as follows:

> SEC. 605. RETROACTIVE REGULATIONS.
>
> Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:
>
> "SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

The purpose of the amendment was to increase further the discretion given to the Treasury. It was intended to permit the Treasury to determine whether a change in regulations should operate prospectively only, even where the change was induced by judicial decision. This was made abundantly clear by the Senate Finance Committee which

stated (S. Rep. No. 960, 70th Cong., 1st Sess., p. 40):[18]

> Section 1108 (a) of the revenue act of 1926 provides that where a regulation or Treasury decision is reversed by a subsequent regulation or Treasury decision, the subsequent decision may be applied without retroactive effect if the reversal is not immediately occasioned or required by a court decision. The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court decision. Fundamentally there is no difference in the

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[18] In accepting the Senate amendment, the Conference Committee declared (H. Rep. No. 1882, 70th Cong., 1st Sess., p. 22):

> Section 1108 (a) of the revenue act of 1926 permits the commissioner to apply a new regulation or Treasury decision without retroactive effect when the new regulation or Treasury decision is not immediately occasioned by a court decision.
>
> This desirable policy has been extended by the Senate amendment so as to include all regulations and Treasury decisions whether or not occasioned by a court decision. It is hoped that this provision will prevent the constant reopening of cases on account of changes in regulations or Treasury decisions, and it is believed that sound administration properly places upon the Government the responsibility and burden of interpreting the law and of prescribing regulations upon which the taxpayers may rely; and the House recedes.

> two cases which can justify the restrictions in section 1108 (a) of the 1926 Act. Accordingly, these restrictions have been removed in section 605 of the bill. * * *

The final change wrought in these provisions appeared in Section 506 of the Revenue Act of 1934, which amended Section 1108 (a) of the 1926 Act as follows:

> SEC. 506. RETROACTIVITY OF REGULATIONS, RULINGS, ETC.
>
> Section 1108 (a) of the Revenue Act of 1926, as amended, is amended to read as follows:
>
> "(a) The Secretary, or the Commissioner with the approval of the Secretary, may prescribe *the extent, if any,* to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect." [Italics supplied.]

The discretion vested in the Treasury was now complete. The Treasury could determine not only whether changes in regulations were to be retrospective in all cases, but it was given the further power of declaring the exact extent of retroactivity. Thus, under the new provisions, the Treasury might provide for a change in regulations that would operate retroactively for any designated period. The committee reports leave no doubt whatever that this was the purpose of these provisions. The House Ways and Means Committee unambiguously explained the amended provisions

as follows (H. Rep. No. 704, 73rd Cong., 2nd Sess., p. 38):

> This section amends section 1108 (a) of the Revenue Act of 1926, as amended, so as to permit the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal revenue taxes shall be applied without retroactive effect. The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. *Regulations, Treasury Decisions, and rulings which are merely interpretive of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department*

> *the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only.* [Italics supplied.]

A similar statement was made by the Senate Finance Committee. S. Rep. 558, 73rd Cong., 2nd Sess., p. 48.

The history of these provisions plainly shows, we submit, that Congress intended the Treasury to have full and complete discretion to determine to what extent changes in regulations are to operate retroactively. Nowhere in the legislative history is there the slightest suggestion that the Treasury's discretion was to be limited, in the language of the *Reynolds* opinion, merely "to correct misinterpretations, inaccuracies, or omissions." 306 U. S. at 116. The broad sweep of the statutory provisions themselves and the clear and persistent statements appearing in the committee reports afford no support whatever for limitation imposed upon those provisions by the *Reynolds* decision. In the circumstances, we think it peculiarly appropriate to ask the Court to reconsider its decision in the *Reynolds* case.

The statutory scheme, as we construe it, is a wise one. It accords full discretion to the Treasury to decide to what extent, if any, a change in practice is to be retroactive. The Treasury is best situated to determine when just expectations would be defeated by a retroactive application of a new regu-

lation, or when taxpayers are likely to have acted in reliance upon prior practice. And it was the intention of Congress to permit the Treasury to call upon its superior fund of information and experience in fixing the limits of operation of a new regulation.

It should not be assumed that the Treasury will abuse that discretion. Indeed, a recent instance of the Treasury's sense of fairness in applying these provisions may be seen in its action following this Court's decision in *Helvering* v. *Hallock*, 309 U. S. 106. The *Hallock* decision had overruled *Helvering* v. *St. Louis Union Trust Co.*, 296 U. S. 39, and thus invalidated the Treasury regulations that had previously been adopted to reflect the result in the *St. Louis Union Trust Co.* case. But the Treasury recognized that transfers of property may have been made between the date of the *St. Louis Union Trust Co.* decision (1935) and the *Hallock* decision in reliance upon those regulations. Accordingly, in promulgating amended regulations to reflect the result of the *Hallock* decision the Treasury has specifically provided that all transfers made during the period between the *St. Louis Union Trust Co.* and *Hallock* decisions are to be governed by the rule of the existing rather than the new regulations. T. D. 5008, promulgated September 19, 1940.

In the instant case, the Treasury apparently felt that there was no occasion to limit the retroactive operation of the regulations. The issue on the merits related to the method of computing reserves.

There was little, if any, likelihood that the prior regulations had induced a course of conduct or other reliance by the insurance companies. It is highly improbable that insurance companies would have conducted their business differently in the absence of such prior regulations. In the circumstances, it was entirely within the Treasury's discretion to conclude that there was no occasion to allow a windfall to the insurance companies by perpetuating a prior erroneous interpretation of the statute; and since the old interpretation probably had not induced a course of conduct, there was no reason to permit the old interpretation to govern pending cases. And to the extent that equities may be thought to arise simply from the passing of time, the Treasury apparently felt that the insurance companies were sufficiently protected by the statute of limitations. Certainly, there was nothing in the Treasury's exercise of discretion here that could be labeled as arbitrary.

We respectfully submit that under Section 1108 (a), as amended by Section 506 of the 1934 Act, the Treasury had full and complete power to amend its regulations with or without retroactive effect; that it amended its regulations here retroactively; that there was reasonable ground for it to believe that it was not defeating any just expectations in so doing; and that there has been no abuse in discretion by the Treasury. To the extent that the *Reynolds* decision indicates that the Treasury was

without power so to act, we respectfully submit that it was incorrectly decided. But, in any event, the *Reynolds* decision is not a bar here because the early regulations in this case were not in harmony with decisions of this Court construing the meaning of "reserves required by law" in relation to life insurance companies.

### CONCLUSION

The reserve deduction issue is not properly before this Court. Since the judgment of the court below could not be affected regardless of how the reserve issue might be decided here, the writ should be dismissed.

But if the Court should conclude that the issue is properly here and should undertake to "declare rights", then the deduction for health and accident reserves claimed by petitioner was not allowable.

Respectfully submitted.

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NOVEMBER 1940.

## APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 201. TAX ON LIFE INSURANCE COMPANIES.

(a) *Definition.*—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

* * * * *

SEC. 202. GROSS INCOME OF LIFE INSURANCE COMPANIES.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

* * * * *

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) RESERVE FUNDS.—An amount equal to * * *[1] 4 per centum of the mean of the re-

[1] The language omitted contains a limitation upon the deduction that was declared unconstitutional in *Nat'l Life Ins. Co.* v. *United States*, 277 U. S. 508, and was eliminated in all later revenue acts.

serve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

* * * * *

The corresponding provisions of the Revenue Act of 1932, c. 209, 47 Stat. 169, are identical with the foregoing, except that subdivision (2) of Section 203 (a) provides for the use of a rate of 3¾ per centum of the mean of the reserve funds instead of 4 per centum in a case where the reserve funds are computed at an interest assumption rate lower than 4 per centum.

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

* * * * *

(b) *Definition of income, etc.*—In the case of an insurance company subject to the tax imposed by this section—

(1) GROSS INCOME.—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain

during the taxable year from the sale or other disposition of property;

(2) NET INCOME.—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

(3) INVESTMENT INCOME.—"Investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) UNDERWRITING INCOME.—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) PREMIUMS EARNED.—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) LOSSES INCURRED.—"Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) EXPENSES INCURRED.—"Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

(c) *Deductions allowed.*—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) Losses sustained during the taxable year from the sale or other disposition of property;

(6) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(7) The amount received as dividends from corporations as provided in section 23 (p);

(8) The amount of interest earned during the taxable year which under section 22 (b) (4) is exempt from taxation under this title, and the amount of interest allowed as a credit under section 26;

(9) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (k);

(10) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $3,000; but if the net income is more than $25,000 the tax imposed by this section shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000.

SEC. 208. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) *Application of title.*—Mutual insurance companies, other than life insurance companies, shall be taxable in the same manner as other corporations, except as hereinafter provided in this section.

(b) *Gross income.*—Mutual marine-insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

(c) *Deductions.*—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE INSURANCE.—In the case of mutual insurance companies other than life insurance companies—

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

(2) MUTUAL MARINE INSURANCE COMPANIES.—In the case of mutual marine insurance companies, in addition to the deductions allowed in paragraph (1) of this subsection, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(3) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE AND MARINE.—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

Article 971 of Regulations 77 (promulgated under Revenue Act of 1932), as amended by T. D. 4615, XIV-2 Cum. Bull. 312, issued December 18, 1935:

> ART. 971. *Tax-exempt interest and reserve funds.*—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:
>
> * * * * *
>
> (2) Four percent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ percent shall be substituted for 4 percent.
>
> In general, the reserve contemplated is a sum of money, variously computed or estimated, which, with accretions from interest, is set aside (reserved) as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims. It must be required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, but such requirement, without more, is not conclusive; for example, it does not include reserves required to be maintained to provide for the ordinary running expenses of a business definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage; the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance; reserve for premiums paid in advance; an-

nual and deferred dividends; accrued but unsettled policy claims; losses incurred but unreported; liability on supplementary contracts not involving life contingencies; estimated value of future premiums which have been waived on policies after proof of total and permanent disability.

In any case where reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered. A company is permitted to make use of the highest aggregate reserve called for by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

* * * * *

Prior to amendment, Article 971 of Regulations 77, *supra*, read as follows:

ART. 971. *Tax-exempt interest and reserve funds.*—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

* * * * *

(2) Four percent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, except that in the case of any such reserve fund which is computed at a lower interest assumption rate, the rate of 3¾ percent shall be substituted for 4 percent. The re-

serve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

* * * Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7–11 of the liability page of the annual statement for life insurance companies, and items 16–19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which

are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered.

Article 971 of Regulations 74 (promulgated under the Revenue Act of 1928) originally was substantially in accord with Article 971 of Regulations 77, but was amended by T. D. 4615, *supra,* to comport with the change in Regulations 77.

Pierce's Code (1929), Vol. 1—Washington General Statutes:

> § 2990.—*Insurance Classified.* § 83. All insurance business in this state is hereby classified as follows:
>
> (1) Fire and marine insurance, * * *; but not upon ocean marine risks, and other casualty insurance risks.
>
> (2) Marine insurance, being ocean and inland risks, * * * but not including any other casualty insurance as hereinafter provided.
>
> (3) Life insurance, being [including] endowments and annuities, but not including health, or accident or sickness insurance or any other casualty insurance as hereinafter provided.
>
> (4) Accident insurance, and either sickness or health insurance being insurance against injury, disablement, or death resulting from travel or general accident, and against disablement resulting from sickness; and every insurance appertaining thereto.
>
> * * * * *
>
> (6) Liability insurance, being all insurance against loss or damage resulting from accident to or injury, fatal or non-fatal, suffered by an employe or other person and for which the insurer is liable.
>
> * * * * *

§ 2991. *Insurance Permitted.* § 84.

* * * * *

*Life.* (3) No stock company shall make insurance in this state under class three of section 83 without having a capital stock fully paid of at least one hundred thousand dollars ($100,000.00) * * *, nor shall such company make insurance in this state in any other of said classes of insurance except in classes four and six; * * *.

* * * * *

§ 2999. *Life—Legal Reserve.* § 92. The commissioner shall annually make valuation of all outstanding policies, additions thereto, unpaid dividends, and all other obligations of every life insurance company doing business in this state; * * *: *Provided further,* That no such standard of valuation * * * shall be less than that determined upon such basis according to the American Experience Table of Mortality with three and one-half per centum interest * * *.

The legal minimum standard for the valuation of annuities issued after January first, nineteen hundred and twelve, shall be "McClintock's Table of Mortality Among Annuitants," or the American Experience Table of Mortality, with interest at three and one-half per centum per annum, * * *.

§ 3001. *Health—Reserve.* § 94. The commissioner shall annually make valuations of all outstanding policies of every company insuring against disablement by sickness, on the net premium basis, according to the "British Friendly Society Tables", eighteen hundred and eighty, or the "Manchester Unity Friendly Society Tables," eighteen hundred and ninety-three to eighteen hun-

dred and ninety-seven, with interest at three and one-half per centum per annum. He may, in his discretion, vary the standard in particular cases, * * *.

Extract from Hearings before the Committee on Finance (Senate), 67th Cong., 1st Sess., on H. R. 8245 (Statement of Dr. T. S. Adams), p. 85:

Dr. ADAMS. Section 242, line 6, page 93:

* * * * *

"That when used in this title the term 'life insurance company' means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contract of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 percent of its total reserve funds."

Senator MCCUMBER. Explain that 50 percent of its total reserve funds, and why take 50 percent instead of some other figure?

Dr. ADAMS. Some companies mix with their life business accident and health insurance. It is not practicable for all companies to disassociate those businesses so that we have assumed that if this accident and health business was more than 50 per cent of their business, as measured by their reserves, it could not be treated as a life insurance company. On the other hand, if their accident and health insurance were incidental and represented less than 50 per cent of their business we treated them as a life insurance company.

Senator MCCUMBER. Suppose that you have those companies in which a certain portion of their business is life insurance and other casualty of any kind, and you have two systems of levying taxes?

Dr. ADAMS. You do not under the House Bill.

Senator MCCUMBER. How do you levy the tax under the two kinds of business in the hands of one company?

Dr. ADAMS. You do not under the House Bill. You did originally under the original suggestion of the Treasury Department, but the House bill now treats them all alike.

Senator DILLINGHAM. In other words, unless a company has a reserve of over 50 per cent on life insurance and annuity contracts it is not a life insurance company?

Dr. ADAMS. No; and it is not very important any more, as you will see. It has only one small application.

Senator MCCUMBER. If they are treated just alike I do not see any necessity of making any distinction.

Dr. ADAMS. They are not treated just alike. There is only one deduction that goes under life insurance alone.

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CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939

No. [redacted] 2

NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

## MOTION TO EXTEND TIME ALLOWED FOR FILING PETITION FOR REHEARING ON PETITIONER'S PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS; AND, IN THE ALTERNATIVE, PETITION FOR A REHEARING ON PETITIONER'S PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

WALTER E. BARTON,
Investment Building,
Washington, D. C.,
*Counsel for Petitioner.*

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939

---

No. 417

---

NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

---

**MOTION TO EXTEND TIME ALLOWED FOR FILING PETITION FOR REHEARING ON PETITIONER'S PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS; AND, IN THE ALTERNATIVE, PETITION FOR A REHEARING ON PETITIONER'S PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.**

---

*To the Honorable the Chief Justices and the Associate Justices of the Supreme Court of the United States:*

Now comes the petitioner in the above-entitled cause and says that on November 22, 1939 its petition for a writ of certiorari to the Court of Claims was denied by this Honorable Court; that the time for filing a petition for a

rehearing herein will expire on December 17, 1939 according to rule 33 of this Court; that said petition for a writ of certiorari raised two questions, namely:

> 1. Whether a portion of total salaries paid by petitioner to its officers and cashiers for part-time services rendered in the investment branch of its business and charged as investment expenses may be deducted by petitioner as "investment expenses" under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932.
>
> 2. Whether petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives are "reserve funds" within the meaning of Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932. (Pp. 8, 9 of Petition for Writ of Certiorari.)

That *Com.* v. *Volunteer State Life Ins. Co.*, No. 7939 is now pending in the Circuit Court of Appeals for the Sixth Circuit on petition for review by the Commissioner from the decision of the Board of Tax Appeals, which was directly contrary to the decision of the Court of Claims in the instant case on the question of investment expenses; that said cause was argued on October 10, 1939, and that a decision thereon should be rendered by the Circuit Court of Appeals at any time; that in the event that the Circuit Court of Appeals for the Sixth Circuit should affirm the Board of Tax Appeals, there will be a direct conflict of a decision of a Circuit Court of Appeals with the decision of the Court of Claims in the instant case.[1]

That *Com.* v. *Monarch Life Ins. Co.*, Nos. 3470, 3475, *Com.* v. *Pan-American Life Ins. Co.*, No. 9175, and *Com.* v. *Oregon Mutual Life Ins. Co.*, No. 9318, are now pending in the Circuit Courts of Appeals for the First, Fifth, and Ninth Circuits, respectively, on petitions for review by the Government from decisions of the Board of Tax Appeals, which were all contrary to the decision of the Court of

[1] The same question also is pending in the Federal District Court of Massachusetts in *Boston Mutual Life Ins. Co.* v. *White*, Nos. 5332, 5333, 5334.

Claims in the instant case on the question of reserve funds; that petitioner is informed by the Clerks of the First and Fifth Circuits, respectively, *Com.* v. *Monarch Life Ins. Co., supra,* will be argued before January 15, 1940; and that *Com.* v. *Pan-American Life Ins. Co., supra,* will be argued not later than early March, 1940, and petitioner has been informed from other sources that *Com.* v. *Oregon Mutual Life Ins. Co., supra,* will be argued early in the spring of 1940; that decisions by the respective Circuit Courts of Appeals are expected in all of said causes before the expiration of the present term of this Honorable Court; and that in the event the Board of Tax Appeals should be affirmed in either of said causes, there will be a direct conflict in a Circuit Court of Appeals with the decision of the Court of Claims in the instant case; that the petitioner is informed and believes that petitions for writs of certiorari will be filed in this Honorable Court in said causes irrespective of whether the issues are decided in favor of the Government or the taxpayers.

That both of the questions involved in the petition for a writ of certiorari herein are different from the ordinary questions arising in tax cases, in that they are recurring ones which affect the rendition of petitioner's income tax returns for each taxable year; that if this Honorable Court should grant certiorari in one of the foregoing causes and decide either of the questions contrary to the decision of the Court of Claims in the instant case, petitioner would be precluded from benefiting from the decision of this Court with respect to the taxable years involved in the instant case, and might be precluded from benefiting with respect to subsequent years under the principle of *res judicata;* that, in fact, petitioner now has pending other cases in which the identical questions are involved; viz., *New World Life Ins. Co.* v. *U. S.,* No. 44599 in the Court of Claims, and *New World Life Ins. Co.* v. *Com.,* No. 98355 in the Board of Tax Appeals; that for the above reasons, in petitioner's humble judgment, it would be just and equitable to extend

the time until the expiration of the present term of this Court within which the petitioner may file a petition for a rehearing on its petition for a writ of certiorari herein.

That petitioner is informed and believes that this Court granted motions extending the time within which to file petitions for rehearing on petitions for writs of certiorari under somewhat similar circumstances in *Farmers Loan and Trust Co.* v. *Bowers*, Nos. 614, 615, October Term, 1938, granted April 2, 1939 until the expiration of the October, 1938 Term, and in *Stone* v. *White*, No. 202, October 1935 Term, granted November 11, 1935 until the end of the October 1935 Term; that further extensions of time were granted in said last-mentioned case on June 1, 1936 until November 2, 1936, and again on October 29, 1936 until December 8, 1936; and that subsequently, this Court in *Stone* v. *White* granted leave to file a petition for a rehearing on the petition for a writ of certiorari out of time; and that this Court later granted certiorari therein.

WHEREFORE, petitioner prays that the time for filing a petition for a rehearing on its petition for a writ of certiorari herein may be extended until the expiration of the present term of this Court.

In the alternative, and in the event that this Honorable Court in its discretion should not grant the further extension of time prayed for in the foregoing motion, the petitioner presents this, its

## PETITION FOR A REHEARING OF ITS PETITION FOR A WRIT OF CERTIORARI.

in the above-entitled cause, and in support thereof, in addition to the facts alleged in its original petition for a writ of certiorari, respectfully shows:

### Relative to Investment Expenses

The Court of Claims originally decided the question of investment expenses in favor of the taxpayer, in *Sun Life*

*Ins. Co.* v. *U. S.* (1935), 81 Ct. Cls. 892; however, that Court decided the identical question in favor of the Government in the instant case.

Whether a life insurance company may take a deduction for investment expenses such as petitioner claims herein is of great importance to life insurance companies and to the Government, inasmuch as it is a recurring question with life insurance companies[2] each year at the time they render their income tax returns, due to the fact that Section 203(a)(5) of the Revenue Acts of 1928 and 1932 have been reenacted in all subsequent revenue acts.

The importance of the question is further evidenced by the fact that the Government filed a petition for review in *Volunteer State Life Ins. Co.* v. *Com.* (1937), 35 B. T. A. 491, in the Circuit Court of Appeals for the Sixth Circuit, which was argued in that court on October 10, 1939.

**Relative to Reserve Funds.**

In the petition for a writ of certiorari (pp. 10, 18) petitioner assigned as one of the reasons for granting the writ, the fact that the Court of Claims absolutely disregarded the decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Company*, 306 U. S. 110, in which this Court expressly held that the Secretary of the Treasury had no authority to amend Regulations that had been in force for a number of years and to apply the amended Regulations retroactively to years prior to the effective date of the amendment. We quote briefly from the opinion by Mr. Justice Roberts as follows:

> "We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.
>
> • • • • • • • • •

[2] Best's Life Ins. Reports for year ending 1938 shows approximately 290 life insurance companies transacting business in the U. S.

"Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

In *Helvering* v. *Wilshire Oil Company, Inc.*, decided by this Court on November 6, 1939, after the filing of petitioner's petition for a writ of certiorari herein, *Reynolds Tobacco* case, if not expressly, was at least impliedly approved by this Court. We quote in part from the opinion of Mr. Justice Douglas as follows:

"But in any event, the validity of the regulations in question seems clear. The oft-repeated statement that administrative construction receives legislative approval by reenactment of a statutory provision, without material change (*United States* v. *Dakota-Montana Oil Co., supra*) covers the situation where the validity of administrative action standing by itself may be dubious or where ambiguities in a statute or rules are resolved by reference to administrative practice prior to reenactment of a statute; and where it does not appear that the rule or practice has been changed by the administrative agency through exercise of its continuing rule-making power. It does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed *prospectively* through exercise of appropriate rule-making powers.

* * * * * * * * *

"The only remaining question is whether Treasury Regulations 74, Art. 221 (i) were within the power of the Commissioner to promulgate. That they were seems clear beyond question. *We are not dealing here, as was this Court in Helvering* v. *R. J. Reynolds Tobacco Co., supra, with regulations applied retroactively. These are applied prospectively only.*" (Italics ours.)

Petitioner respectfully submits that the law is now settled by these two decisions of this Court handed down during the present year that the Commissioner may amend his regulations and apply them prospectively to *subsequent years*, but that he may not amend them and apply them retroactively to *prior years*, as the Court of Claims did in the instant case.

Beginning on page 10 of the petition for a writ of certiorari, and beginning on page 18 of the brief in support thereof, the petitioner set forth the undisputed facts that the Commissioner's regulations from 1921 until 1935 expressly authorized a deduction of the statutory percentage of the mean of disability reserves, active lives, and disabled lives, such as petitioner claims herein; that the life insurance income tax return, Form 1120L, prepared by the Commissioner, contained lines for such deductions; that it was not until December 18, 1935, practically three years after the end of the last taxable year involved in this proceding, that the Commissioner, by T. D. 4615, amended his regulations by eliminating therefrom the provision authorizing the deduction; and that following amendment thereof, the Commissioner applied them retroactively and disallowed the same character of deductions for petitioner's taxable years 1929 to 1932, inclusive, which he actually had allowed for all prior years beginning in 1921.

The question is pertinent as to whether an inferior court may decide a case in direct conflict with the decision of this Court, with the result that its decision shall be final and conclusive upon the parties, which will be the result in this case unless this Court should grant petitioner's petition for a writ of certiorari herein.

The importance of this question is further evidenced by the fact that the Commissioner in each case decided against him by the Board of Tax Appeals has filed petitions for review; viz., *Com.* v. *Monarch Life Ins. Co.*, *Com.* v. *Oregon Mutual Life Ins. Co.*, and *Com.* v. *Pan-American Life Ins. Co.* Furthermore, the question is almost certain to be pre-

sented to this Court during the next few months, as petitioner is informed and believes that decisions of the respective Circuit Courts of Appeals in all probability will be handed down during the present term of this Court, and petitions for writs of certiorari will be filed in said causes irrespective of how they are decided by the Circuit Courts of Appeals.

**Prayer.**

WHEREFORE, petitioner prays that its petition for a rehearing on its petition for a writ of certiorari may be granted; and that upon reconsideration, this Court may vacate its order entered herein on November 22, 1939 and enter a new order granting the petition for a writ of certiorari in this cause.

Respectfully submitted,

WALTER E. BARTON,
Investment Building,
Washington, D. C.,
*Counsel for Petitioner.*

**CERTIFICATE OF COUNSEL.**

The undersigned, counsel for petitioner herein, hereby certifies that the foregoing motion to extend time allowed for filing petition for rehearing on petitioner's petition for a writ of certiorari, and, in the alternative petition for a rehearing on petitioner's petition for a writ of certiorari are presented in good faith and not for delay.

WALTER E. BARTON,
*Counsel for Petitioner.*

Dated, Washington, D. C.
December 9, 1939.

FILED
MAR 4 1940
CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939

No. [redacted] 2

NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

## MOTION TO EXTEND TIME ALLOWED FOR FILING PETITION FOR REHEARING ON PETITIONER'S PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS; AND, IN THE ALTERNATIVE, PETITION FOR A REHEARING ON PETITIONER'S PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

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PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939

---

No. 417

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NEW WORLD LIFE INSURANCE COMPANY, a Corporation,
*Petitioner,*

v.

THE UNITED STATES.

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**MOTION TO EXTEND TIME ALLOWED FOR FILING PETITION FOR REHEARING ON PETITIONER'S PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS; AND, IN THE ALTERNATIVE, PETITION FOR A REHEARING ON PETITIONER'S PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.**

---

*To the Honorable the Chief Justices and the Associate Justices of the Supreme Court of the United States:*

Now comes the petitioner in the above-entitled cause and says that on November 22, 1939 its petition for a writ of certiorari to the Court of Claims was denied by this Honorable Court; that on December 11, 1939, the petitioner filed a motion to extend the time allowed for filing a peti-

tion for a rehearing on petitioner's petition for a writ of certiorari, and in the alternative a petition for a rehearing on petitioner's petition for a writ of certiorari herein; that on December 18, 1939, this Honorable Court entered an order granting petitioner's said motion and extending the time until March 15, 1940, within which to file a petition for a rehearing herein; that the time for filing a petition for a rehearing herein will expire on March 15, 1940, according to said order of this Court.

That petitioner's said petition for a writ of certiorari raised two questions, namely:

> 1. Whether a portion of total salaries paid by petitioner to its officers and cashiers for part-time services rendered in the investment branch of its business and charged as investment expenses may be deducted by petitioner as "investment expenses" under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932.
>
> 2. Whether petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives are "reserve funds" within the meaning of Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932. (Pp. 8, 9 of Petition for Writ of Certiorari.)

That *Com.* v. *Volunteer State Life Ins. Co.*, No. 7939 is now pending in the Circuit Court of Appeals for the Sixth Circuit on petition for review by the Commissioner from the decision of the Board of Tax Appeals, which was directly contrary to the decision of the Court of Claims in the instant case on the question of investment expenses; that said cause was argued approximately five months ago on October 10, 1939, and that a decision thereon should be rendered by the Circuit Court of Appeals very soon; that in the event that the Circuit Court of Appeals for the Sixth Circuit should affirm the Board of Tax Appeals, there will be a direct conflict of a decision of a Circuit Court of Appeals with the decision of the Court of Claims in the instant case.

That the same question also is pending in the Federal District Court of Massachusetts in *Boston Mutual Life Ins.*

*Co.* v. *White,* Nos. 5332, 5333, 5334; but petitioner has been informed by the Department of Justice that these cases are now on the reserve calendar of said court pending the decision of the Circuit Court of Appeals for the Sixth Circuit in *Com.* v. *Volunteer State Life Ins. Co., supra.*

That *Com.* v. *Monarch Life Ins. Co.,* Nos. 3470, 3475, *Com.* v. *Pan-American Life Ins. Co.,* No. 9175, and *Com.* v. *Oregon Mutual Life Ins. Co.,* No. 9318, are now pending in the Circuit Courts of Appeals for the First, Fifth, and Ninth Circuits, respectively, on petitions for review by the Commissioner of decisions of the Board of Tax Appeals, which were all contrary to the decision of the Court of Claims in the instant case, on the question of reserve funds; that petitioner has been informed by the Department of Justice as follows:

That *Com.* v. *Pan-American Life Ins. Co., supra,* has been set down for argument in the Circuit Court of Appeals for the Fifth Circuit on March 11, 1940; that *Com.* v. *Monarch Life Ins. Co., supra,* was set down for argument in the Circuit Court of Appeals for the First Circuit during the January Term of that Court, but that due to illness of Counsel for respondent the same was passed and reset for argument during the April Term; that the Government's brief has been filed in *Com.* v. *Oregon Mutual Life Ins. Co., supra,* and that the respondent's brief will be filed shortly, when said case is expected to be set down for argument in the Circuit Court of Appeals for the Ninth Circuit during the spring of 1940.

That decisions by the respective Circuit Courts of Appeals in all probability will be handed down in all of said causes before the expiration of the present term of this Honorable Court; and that in the event the Board of Tax Appeals should be affirmed in either of said causes, there will be a direct conflict in a Circuit Court of Appeals with the decision of the Court of Claims in the instant case; that the petitioner is informed and believes that petitions for writs of certiorari will be filed in this Honorable Court in

said causes irrespective of whether the issues are decided in favor of the Government or the taxpayers.

That both of the questions involved in the petition for a writ of certiorari herein are different from the ordinary questions arising in tax cases, in that they are recurring ones which affect the rendition of petitioner's income tax returns for each taxable year; that if this Honorable Court should grant certiorari in one of the foregoing causes and decide either of the questions contrary to the decision of the Court of Claims in the instant case, petitioner would be precluded from benefiting from the decision of this Court with respect to the taxable years involved in the instant case, and might be precluded from benefiting with respect to subsequent years under the principle of *res judicata;* that, in fact, petitioner now has pending other cases in which the identical questions are involved; viz., *New World Life Ins. Co.* v. *U. S.*, No. 44599 in the Court of Claims, and *New World Life Ins. Co.* v. *Com.*, No. 98355 in the Board of Tax Appeals; that for the above reasons, in petitioner's humble judgment, it would be just and equitable to extend the time until the expiration of the present term of this Court within which the petitioner may file a petition for a rehearing on its petition for a writ of certiorari herein.

That petitioner is informed and believes that this Court granted motions extending the time within which to file petitions for rehearing on petitions for writs of certiorari under somewhat similar circumstances in *Farmers Loan and Trust Co.* v. *Bowers*, Nos. 614, 615, October Term, 1938, granted April 2, 1939 until the expiration of the October, 1938 Term, and in *Stone* v. *White*, No. 202, October 1935 Term, granted November 11, 1935 until the end of the October 1935 Term; that further extensions of time were granted in said last-mentioned case on June 1, 1936 until November 2, 1936, and again on October 29, 1936 until December 8, 1936; and that subsequently, this Court in *Stone* v. *White* granted leave to file a petition for a rehearing on the petition for a writ of certiorari out of time; and that this Court later granted certiorari therein.

WHEREFORE, petitioner prays that the time for filing a petition for a rehearing on its petition for a writ of certiorari herein may be extended until the expiration of the present term of this Court.

In the alternative, and in the event that this Honorable Court in its discretion should not grant the further extension of time prayed for in the foregoing motion, the petitioner presents this, its

## PETITION FOR A REHEARING OF ITS PETITION FOR A WRIT OF CERTIORARI

in the above-entitled cause, and in support thereof, in addition to the facts alleged in its original petition for a writ of certiorari, respectfully shows:

### Relative to Investment Expenses

The Court of Claims originally decided the question of investment expenses in favor of the taxpayer, in *Sun Life Ins. Co.* v. *U. S.* (1935), 81 Ct. Cls. 892; however, that Court decided the identical question in favor of the Government in the instant case.

Whether a life insurance company may take a deduction for investment expenses such as petitioner claims herein is of great importance to life insurance companies and to the Government, inasmuch as it is a recurring question with life insurance companies[1] each year at the time they render their income tax returns, due to the fact that Section 203(a)(5) of the Revenue Acts of 1928 and 1932 have been reenacted in all subsequent revenue acts.

The importance of the question is further evidenced by the fact that the Government filed a petition for review in *Volunteer State Life Ins. Co.* v. *Com.* (1937), 35 B. T. A. 491, in the Circuit Court of Appeals for the Sixth Circuit,

[1] Best's Life Ins. Reports for year ending 1938 shows approximately 290 life insurance companies transacting business in the U. S.

which was argued in that court on October 10, 1939, but not yet decided.

**Relative to Reserve Funds**

In the petition for a writ of certiorari (pp. 10, 18) petitioner assigned as one of the reasons for granting the writ, the fact that the Court of Claims absolutely disregarded the decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Company*, 306 U. S. 110, in which this Court expressly held that the Secretary of the Treasury had no authority to amend Regulations that had been in force for a number of years and to apply the amended Regulations retroactively to years prior to the effective date of the amendment. We quote briefly from the opinion by Mr. Justice Roberts as follows:

> "We hold that the respondent's tax liability for the year 1929 is to be determined in conformity to the regulation then in force.
>
> • • • • • • • • • •
>
> "Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

In *Helvering* v. *Wilshire Oil Company, Inc.*, 308 U. S. 90, the *Reynolds Tobacco* case, if not expressly, was at least impliedly approved by this Court. We quote in part from the opinion of Mr. Justice Douglas as follows:

> "But in any event, the validity of the regulations in question seems clear. The oft-repeated statement that administrative construction receives legislative approval by reenactment of a statutory provision, without material change (*United States* v. *Dakota-Montana Oil Co., supra*) covers the situation where the validity of administrative action standing by itself may be dubious or where ambiguities in a statute or rules are resolved by reference to administrative practice prior

to reenactment of a statute; and where it does not appear that the rule or practice has been changed by the administrative agency through exercise of its continuing rule-making power. It does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that that administrative interpretation cannot be changed *prospectively* through exercise of appropriate rule-making powers.

* * * * * * * *

"The only remaining question is whether Treasury Regulations 74, Art. 221 (i) were within the power of the Commissioner to promulgate. That they were seems clear beyond question. *We are not dealing here, as was this Court in Helvering* v. *R. J. Reynolds Tobacco Co., supra, with regulations applied retroactively. These are applied prospectively only.*" (Italics ours.)

Petitioner respectfully submits that the law is now settled by these two decisions of this Court handed down during 1939 that the Commissioner may amend his regulations and apply them prospectively to *subsequent years,* but that he may not amend them and apply them retroactively to *prior years,* as the Court of Claims did in the instant case.

Beginning on page 10 of the petition for a writ of certiorari, and beginning on page 18 of the brief in support thereof, the petitioner set forth the undisputed fact that the Commissioner's regulations from 1921 until 1935 expressly authorized a deduction of the statutory percentage of the mean of disability reserves, active lives, and disabled lives, such as petitioner claims herein; that the life insurance income tax return, Form 1120L, prepared by the Commissioner, contained lines for such deductions; that it was not until December 18, 1935, practically three years after the end of the last taxable year involved in this proceeding, that the Commissioner, by T. D. 4615, amended his regulations by eliminating therefrom the provision authorizing the deduction; and that following amendment thereof,

the Commissioner applied them retroactively and disallowed the same character of deductions for petitioner's taxable years 1929 to 1932, inclusive, which he actually had allowed for all prior years beginning in 1921 in accordance with existing regulations.

May an inferior court decide a case in *direct conflict* with the decision of this Court, which the Court of Claims did in this case, with the result that its decision shall be final and conclusive upon the parties, without resort to this Court for relief? Unless this Court grants petitioner's petition for a writ of certiorari herein the answer will be in the affirmative.

The importance of this question is further evidenced by the fact that the Commissioner in each case decided against him by the Board of Tax Appeals has filed petitions for review; viz., *Com.* v. *Monarch Life Ins. Co.*, *Com.* v. *Oregon Mutual Life Ins. Co.*, and *Com.* v. *Pan-American Life Ins. Co., supra.* Furthermore, the question is almost certain to be presented to this Court during the next few months, as petitioner is informed and believes that decisions of the respective Circuit Courts of Appeals in all probability will be handed down during the present term of this Court, and that petitions for writs of certiorari will be filed in said causes irrespective of how they are decided by the Circuit Courts of Appeals.

## Prayer.

WHEREFORE, petitioner prays that its petition for a rehearing on its petition for a writ of certiorari may be granted; and that upon reconsideration, this Court may vacate its order entered herein on November 22, 1939 and enter a new order granting the petition for a writ of certiorari in this cause.

Respectfully submitted,

WALTER E. BARTON,
Investment Building,
Washington, D. C.,
*Counsel for Petitioner.*

## CERTIFICATE OF COUNSEL.

The undersigned, counsel for petitioner herein, hereby certifies that the foregoing motion to extend time allowed for filing petition for rehearing on petitioner's petition for a writ of certiorari, and, in the alternative petition for a rehearing on petitioner's petition for a writ of certiorari are presented in good faith and not for delay.

WALTER E. BARTON,
*Counsel for Petitioner.*

Dated, Washington, D. C.
March 4, 1940.

FILE COPY

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CHARLES ELMORE CROPLEY
CLERK

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 2

NEW WORLD LIFE INSURANCE COMPANY, A CORPORATION,
*Petitioner,*

v.

THE UNITED STATES.

**On Petition for a Writ of Certiorari to the United States Court of Claims.**

## PETITION FOR REHEARING.

WALTER E. BARTON,
*Washington, D. C.,*
*Counsel for Petitioner.*

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1939.

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No. 417.

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NEW WORLD LIFE INSURANCE COMPANY, A CORPORATION,
*Petitioner,*

v.

THE UNITED STATES.

---

**On Petition for a Writ of Certiorari to the United States Court of Claims.**

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## PETITION FOR REHEARING.

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*To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:*

Comes now the petitioner, New World Life Insurance Company, by Walter E. Barton, its attorney of record, and presents this, its petition for rehearing on its petition for a writ of certorari in the above-entitled cause for the reasons hereinafter stated.

## Jurisdiction.

The jurisdiction of this Honorable Court is set out on pages 1 and 2 of the petition for a writ of certiorari.

On September 25, 1939, the petition for a writ of certiorari to the United States Court of Claims herein was filed; and on November 22, 1939, the same was denied by this Honorable Court. On December 11, 1939, petitioner filed a motion to extend the time allowed for filing a petition for rehearing; and on December 18, 1939, this Honorable Court entered an order granting petitioner's said motion and extending the time until March 15, 1940. On March 4, 1940, petitioner filed another motion to extend the time allowed for filing a petition for rehearing; and on March 11, 1940, this Honorable Court entered an order granting petitioner's said motion and extending the time until May 1, 1940 within which to file a petition for a rehearing herein.

## Questions Presented.

The petition for a writ of certiorari herein raises the following questions:

1. Whether a portion of total salaries paid by petitioner to its officers and cashiers for part-time services rendered in the investment branch of its business and charged as investment expenses may be deducted by petitioner as "investment expenses" under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932.

2. Whether petitioner's Disability Reserve, Active Lives and its Disability Reserve, Disabled Lives are "reserve funds" within the meaning of Sec. 203 (a) (2) of the Revenue Acts of 1928 and 1932. (Pp. 8, 9 of Petition for Writ of Certiorari, R. 17.)

The Circuit Court of Appeals for the Sixth Circuit has reversed the Board of Tax Appeals in *Com.* v. *Volunteer State Life Ins. Co.*, No. 7939, on the investment expense question, and that case is now pending in this Court on

petition for a writ of certiorari by the insurance company in No. 920.

The Circuit Court of Appeals for the Fifth Circuit has affirmed the Board of Tax Appeals in *Com.* v. *Pan American Life Ins. Co.*, No. 9175, on the disability reserve question, its decision being in direct conflict with the decision of the Court of Claims in the instant case; and petitioner is informed that the government intends to apply for a writ of certiorari in the *Pan American* case.

## Statement of the Case.

The material facts as found by the Court of Claims are as follows:

### *Investment Expenses*

Petitioner is a stock life insurance company organized under the laws of the State of Washington (R. 17). On November 22, 1929, petitioner's board of directors passed a resolution providing that petitioner's disbursements for office salaries paid should be charged between investment expense and insurance expense in the following proportions:

| *Name* | *Investment* | *Insurance* |
|---|---|---|
| John J. Cadigan (President) | 50% | 50% |
| Edward J. O'Shea (Treasurer) | 80% | 20% |
| Graves, Mizer & Graves (General Counsel) | 75% | 25% |
| Cashiers in Offices at Seattle, Portland, and San Diego | 25% | 75% |
| Cashiers in Offices at Oakland and Los Angeles | 50% | 50% |
| All other employees mentioned | 100% | |

(R. 24.)

In the case of officers, the foregoing percentages represent estimates arrived at by the respective officers, and in the case of cashiers, estimates arrived at by supervising officers in charge of such cashiers, after a careful consideration of the duties theretofore performed by such officers

and cashiers, respectively, and which it was estimated they would perform in the future. The respective officers and cashiers devoted at least as much of their time to the investment department of petitioner's business for the taxable years 1929 to 1932, inclusive, as the percentages set forth in said resolution. (R. 25.)

The salaries paid by petitioner to the officers and cashiers named during the taxable years involved were as follows:

| | 1929 | 1930 | 1931 | 1932 |
|---|---|---|---|---|
| President | $18,000.00 | $18,000.00 | $18,000.00 | $18,000.00 |
| Treasurer | 8,500.00 | 9,875.00 | 10,000.00 | 10,000.00 |
| General Counsel | 1,800.00 | 1,800.00 | 3,112.50 | 5,619.08 |
| Seattle Cashier | | 2,320.64 | 1,325.28 | 1,210.00 |
| Oakland Cashier | | 1,540.00 | 1,750.00 | 2,240.00 |
| Portland Cashier | | 720.00 | 1,330.00 | 1,330.00 |
| Los Angeles Cashier | | 3,215.00 | 3,200.00 | 3,200.00 |
| Spokane Cashier | | | 3,200.00 | 3,980.00 |

(R. 24.)

During said taxable years 1929 to 1932, inclusive, petitioner charged on its books and deducted in its income returns as investment expenses for part-time services rendered in the investment department amounts equal to the same percentages of total salaries paid to its said officers and cashiers which said resolution provided should be charged to investment expenses. The Commissioner allowed as investment expenses, deductions for total salaries paid as provided in said resolution, where the entire time of the employees was devoted to the investment department; but the Commissioner disallowed as investment expenses, deductions for portions of total salaries paid as provided in said resolution, where only a part of the time of the officers and cashiers was devoted to the investment department. The Court of Claims sustained the Commissioner. (R. 18-25.)

## Reserve Funds.

Petitioner writes non-participating life insurance contracts, including combined life, health, and accident insurance the reserve funds of which held for the fulfillment of

such contracts comprise more than 50 per centum of its total reserve funds. Petitioner writes some separate life policies but no separate disability and/or accidental death policies. All of petitioner's policies are written on the level premium plan. (R. 17-26, 29, 30.)

Each policy covering combined life, health, and accident insurance shows the total premium on the face of the policy, which includes the life premium, the disability premium, and the accident premium, the last two of which are also stated separately elsewhere in the policy. The cancelation or termination of the life insurance, automatically cancels or terminates the disability and accident insurance; but the policyholder may discontinue the disability and/or accident insurance at any premium-paying date without discontinuing the life insurance, in which event the total premium shown on the face of the policy is correspondingly reduced. (R. 26, 61, 66.)

Petitioner sets up a separate life reserve out of the life premiums, and a separate accidental death benefit reserve out of the accident premiums, neither of which is in controversy here. Petitioner also sets up a separate reserve out of the disability premiums, commonly known as Reserve for Total and Permanent Disability Benefits, Active Lives, hereinafter referred to as Disability Reserve, Active Lives. In calculating the disability premium, the rate of disability, the rate of mortality, the rate of interest, and the rate of expense are taken into consideration. The Disability Reserve, Active Lives, is computed in accordance with an adopted mortality and disability table (usually Hunter's Combined Table of Mortality and Disability) improved with an assumed rate of interest (usually 3 per cent to 3½ per cent compound interest). This reserve relates to outstanding disability insurance in force with respect to which total and permanent disability has *not* occurred. (R. 27-29.)

When a person carrying disability insurance *becomes* totally and permanently disabled, petitioner transfers a certain amount from its Disability Reserve, Active Lives, to

another reserve, commonly called Reserve for Total and Permanent Disability Benefits, Disabled Lives, hereinafter referred to as Disability Reserve, Disabled Lives. The amount transferred is calculated upon the basis of selected tables of probability of length of disability and expected benefits (such as Hunter's Disabled Lives Mortality Table), improved with an assumed rate of interest (usually 3½ per cent compound interest), mortality also being taken into consideration. When a policyholder becomes totally and permanent disabled, it is not possible to determine the amount of the disability benefits likely to be payable under the policy, due to the fact that disability payments cease upon the death of the disabled persons and also upon the termination of his disability while living. (R. 28, 29, 66.)

Petitioner's Disability Reserve, Active Lives, is computed in accordance with standard combined mortality and disability tables, and its Disability Reserve, Disabled Lives, is computed in accordance with standard mortality and disability tables for disabled lives, as required by the laws of the State of Washington and/or the rules and regulations of the Insurance Commissioner of that state. The petitioner deducted the statutory percentage of the mean of said reserve funds held by it at the beginning and end of the taxable years 1929 to 1932, inclusive, as provided in Section 203 (a) (2) of the Revenue Acts of 1928 and 1932. The Court of Claims held that the deduction was not allowable. (R. 29, 30, 60.)

The regulations from 1921 to 1935 authorized a deduction of the statutory percentage of the mean of the Disability Reserve, Active Lives, and the Disability Reserve, Disabled Lives. Furthermore, Form 1120-L (corporate life insurance income tax return for the years 1921 to 1935, prepared by the Commissioner) contained lines for said deductions. On December 18, 1935, T. D. 4615 amended the regulations applicable to the Revenue Acts of 1921, 1924, 1926, 1928 and 1932, by omitting therefrom the authorization for, but not expressly denying said deductions. The original regulations applicable to each of said Revenue Acts, contain a

specific authorization for a deduction with respect to disability reserves *not required by law* in the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly-premium payment plan. These regulations as amended by T. D. 4615, as well Article 203 (a) (2)-1, Reg. 86 (1934 Act), Art. 203 (a) (2)-1, Reg. 94 (1936 Act) and Art. 203 (a) (2)-1, Reg. 101 (1938 Act), still contained this identical provision with respect to disability reserves *not required by law* in the case of such policies. (Appendix, p. 32, of Petition for Certiorari.)

**Reasons for Granting the Writ.**

*Relative to Investment Expenses*

1. On March 12, 1940, the United States Circuit Court of Appeals for the Sixth Circuit in *Com.* v. *Volunteer State Life Ins. Co.*, No. 7939, held that a life insurance company was not entitled to deduct as investment expenses under Sec. 203 (a) (5) of the Revenue Act of 1928 salaries paid to its officers for part time services rendered in the investment department pursuant to a contract entered into between the insurance company and its said officers, where such officers also performed some general services and were paid additional amounts for such general services pursuant to said contract.

Circuit Judge Arant dissented from the majority holding, and petitioner submits that his dissenting opinion, which follows, correctly construes Sec. 203(a)(5) of the Revenue Act of 1928:

> "I cannot agree, however, that the salary item includes general expense. The reasoning of the Court of Claims in New World Life Ins. Co. v. United States, supra, upon which the majority relies, assumes, as its starting point, that, within the meaning of the Act, all the compensation of an officer who renders any general service whatever is necessarily general expense, no matter how much service of a strictly departmental character he may render pursuant to a 'reasonable and

> fair' contract separately made for such service. I regard as sounder the view expressed by the same Court in Sun Life Ins. Co. v. United States, 12 F. Supp. 450 (supra)." (Prentice Hall, 1940 Tax Service, Vol. 4, Par. 62487.)

The insurance company has filed a petition for a writ of certiorari in *Volunteer State Life Insurance Company* v. *Com.*, No. 920, which is now pending in this Court; and petitioner respectfully submits that in the event that this Court should grant certiorari in that case, this Court also should grant the writ in the petitioner's case on the investment expense question.

2. The Court of Claims has rendered a decision in direct conflict with its own previous decision in *Sun Life Ins. Co.* v. *U. S.*, (1935), 81 Ct. Cls. 892, no petition for a writ of certiorari being filed.

In the *Sun Life* case, the Court of Claims held that where a certain percentage of total salaries was paid to officers for part time services rendered in the investment department, the amount paid was deductible as investment expenses under Sec. 245 (a) (5) of the Revenue Act of 1924.[1]

In the *Sun Life* case the Court of Claims held that the proviso regarding assignment of general expenses to investment expenses was applicable only

> "when an attempt was made to improperly increase the amount of investment expenses. The purpose of the proviso so far as we can determine from the language used and its connection with the remainder of the section is to prevent 'padding' of the investment expenses by requiring the insurance companies to make a definite

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[1] Sec. 245 (a) (5) of the Revenue Act of 1924 is identical with Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932 and reads as follows:

> "Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year."

> showing of how much has been expended for investment purposes and how much upon the insurance business."

Clearly the petitioner made such a showing in the instant case, inasmuch as the Court of Claims found that careful consideration was given to the amount of time being rendered and expected to be rendered in the investment department before the resolution was adopted, and that the petitioner's officers and cashiers actually rendered as much time in its investment department as the resolution indicated. (R. 24, 25.) Consequently there was no "padding" of investment expenses by assigning thereto general expenses, which the proviso of Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932 seeks to prevent.

3. The Court of Claims has rendered a decision contrary to the principle announced by this Court in *Rockford Life Ins. Co.* v. *Com.*, 292 U. S. 382.

In that case this Court held that notwithstanding the generality of the language used in Section 203 (a) (7) of the Revenue Act of 1928 allowing

> "a reasonable allowance for the exhaustion, wear, and tear of property, including a reasonable allowance for obsolescence,"

the deduction should be limited to "depreciation to the property that is used in connection with the company's investment business." This Court said:

> "There is adequate evidence that Congress intended to limit deductions of expenses to those related to the taxed income. *Helvering* v. *Independent Life Ins. Co.*, 292 U. S. 371. In the reports of committees having in charge the Act of 1921, in which first appeared the language under consideration, Section 203 (a) (7), it is said: 'The proposed plan would tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions

for expenses fairly chargeable against such investment income.[2] Section 203 (a) (5) by restricting deductions to investment expenses indicates purpose to exclude those not related to investment income."

If the general language of Section 203 (a) (7), granting an allowance for depreciation of property, is to be construed to refer only to property used in connection with the investment department, clearly, the petitioner is entitled to a deduction for the portion of the salaries paid to its officers and cashiers for services rendered in its investment department.

The Court of Claims found that petitioner's, officers and cashiers devoted at least as great a proportion of their time to its investment department as the percentages of total salaries which were charged to investment expenses. The amount of salaries paid for part-time services in the investment department clearly is investment expenses and not general expenses such as the following: (1) General advertising; (2) salaries of legislative counsel, public relations counsel, and advertising manager; (3) costs of publishing and mailing annual reports and financial statements; (4) traveling expenses of company officials attending national conventions; (5) dues and assessments paid to certain bureaus and associations; (6) costs of books, newspapers, and periodicals not used exclusively in either the investment or underwriting departments; (7) public liability insurance premiums; (8) charitable donations and contributions; (9) license fees paid to various states for the privileges of doing business therein; and (10) cost of insurance department examinations. Inasmuch as the latter expenses are incurred for the benefit of the investment *and* the underwriting departments, they properly should be classified as general expenses and not as investment expenses or underwriting expenses.

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[2] 67th Cong., 1st Sess., Senate Report No. 275, p. 20; House Report No. 350, p. 14.

4. The Court of Claims has decided an important question of Federal law which has not been, but should be settled by this Honorable Court.

It is conceded in this case that the entire salary of an officer or employee is deductible as investment expenses, if he devotes his entire time to the investment department. The question of whether a portion of total salaries paid to officers and employees for part-time services actually rendered in the investment department and actually charged on the books as investment expenses may be deducted by a life insurance company as investment expenses under Sec. 203 (a) (5) of the Revenue Acts of 1928 and 1932 and corresponding provisions of other Acts is an important one to life insurance companies and to the Government. Applying the question to the instant case: May the petitioner deduct as investment expenses 50 per cent of the salary paid to its president for services rendered in its investment department, when the Court of Claims found (R. 24, 25) that petitioner's president devoted at least 50 per cent of his time to the investment department of petitioner's business, and that 50 per cent of his salary was charged on petitioner's books and deducted in its income tax returns as investment expenses?

Best's Life Insurance Reports (1938) show that there are at least 300 life insurance companies doing business in the United States. Furthermore, petitioner has been informed that a considerable number of cases involving this question are now pending in the Treasury Department and the following cases involving this issue are now pending in the courts and the Board of Tax Appeals:

*Amicable Life Insurance Company, Court of Claims,* No. 44599.

*Boston Mutual Life Insurance Company* v. *White,* Federal District Court of Mass., Nos. 5332, 5333, 5334.

*United Life & Accident Insurance Company, Board of Tax Appeals,* Nos. 85321, 93815.

*New World Life Insurance Company, Court of Claims,* No. 44588.
*New World Life Insurance Company, Board of Tax Appeals,* No. 98355.

*Relative to Reserve Funds*

1. The decision of the Court of Claims is in direct conflict with the decision of the United States Circuit Court of Appeals for the Fifth Circuit in *Com.* v. *Pan American Life Insurance Company,* No. 9175.

On April 20, 1940, the Circuit Court of Appeals for the Fifth Circuit in *Com.* v. *Pan-American Life Ins. Co.,* No. 9175, affirmed the Board of Tax Appeals (38 B. T. A. 1430) and held that the term "reserve funds" in Sec. 203 (a) (2) of the Revenue Act of 1932 included reserve funds held for incurred disability benefits, which are identical with petitioner's Disability Reserves, Disabled Lives. The decision of the Circuit Court of Appeals, in so far as it applies to this issue, is printed in the Appendix, p. 15.

2. The decision of the Court of Claims is in direct conflict with the decision of this Court in *Helvering* v. *R. J. Reynolds Tobacco Co.,* 306 U. S. 110.

The Commissioner's Regulations from 1921 to 1935 specifically authorized a deduction with respect to Disability Reserves, Active Lives and Disability Reserves, Disabled Lives. On December 18, 1935 T. D. 4615 amended the Regulations which had been in existence for these fourteen years by omitting the authorization for (but not expressly denying) the deductions with respect to said disability reserves. (Appendix p. 32, Petition for Certiorari.) The Court of Claims held that the Amended Regulations, T. D. 4615, promulgated in 1935, were applicable to petitioner's years 1929 to 1932, inclusive. In the petition for a writ of certiorari, (p. 10) petitioner maintained that the decision of the Court of Claims in this respect was contrary to *Helvering* v. *R. J. Reynolds Tobacco Co.,* 306 U. S. 110. The Circuit Court of Appeals in *Com.* v. *Pan American Life Ins. Co., supra,* said:

"The attempt of the Commissioner to apply 1935 Treasury Regulations to tax returns made for the year 1933 falls within the prohibition against retroactive application mentioned in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110."

3. The Court of Claims has decided an important question of Federal law, which has not been but should be decided by this Court.

Best's Life Insurance Reports (1938) show that there are at least 290 life insurance companies writing disability insurance in the United States. The question therefore, is of great importance to these 290 insurance companies. The importance of the question to the government is evidenced by the fact that the Commissioner has appealed from the decisions of the Board of Tax Appeals in three cases which the Board has decided; viz., *Com.* v. *Pan American Life Insurance Company, supra,* which has been decided adversely to the government, and

*Com.* v. *Monarch Life Ins. Co.*, Nos. 3470, 3475 (1st Circuit) argued on April 16, 1940, and now awaiting decision;

*Com.* v. *Oregon Mutual Life Ins. Co.*, No. 9318 (9th Circuit) argued on April 3, 1940, and now awaiting decision.

## PRAYER.

WHEREFORE, petitioner prays that its petition for rehearing of its petition for a writ of certiorari herein may be granted; and that upon reconsideration, this Honorable Court may vacate its order entered herein on November 22, 1939, and enter a new order granting the petition for a writ of certiorari in this cause.

Respectfully submitted,

WALTER E. BARTON,
*Investment Building,*
*Washington, D. C.,*
*Counsel for Petitioner.*

**Certificate of Counsel.**

The undersigned, counsel for petitioner herein, hereby certifies that the foregoing petition for rehearing is presented in good faith and not for delay.

WALTER E. BARTON,
*Counsel for Petitioner.*

Dated, Washington, D. C.
April 30, 1940.

**Appendix.**

IN THE

# UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE FIFTH CIRCUIT

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No. 9175

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COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

versus

PAN-AMERICAN LIFE INSURANCE COMPANY,
Respondent,

And

PAN-AMERICAN LIFE INSURANCE COMPANY,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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*Petitions for Review of Decision of the United States Board of Tax Appeals (District of Louisiana).*

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(April 20, 1940)

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Before Sibley, Hutcheson, and Holmes
*Circuit Judges.*

Holmes, Circuit Judge: These two petitions for review were consolidated for purposes of the hearing but the questions presented are distinct, and will be dealt with separately in this opinion.

In the first case, the question is whether reserves required by state law to be maintained by life insurance companies for the payment of incurred disability benefits are reserves required by law within the meaning of Section 203

(a) (2) of the Revenue Act of 1932. The board held that they were. 38 B. T. A. 1430.

The taxpayer is an insurance company incorporated under the laws of Louisiana. During the tax year 1933, it did business in Louisiana, Oklahoma, Indiana, and Illinois. More than fifty per centum of its total reserve funds was held for the fulfillment of its life-insurance and annuity contracts. Some of its policies provided for the waiver of premiums in event of the total and permanent disability of the insured, so long as such disability continued; others provided for the payment of monthly disability benefits. The laws of Oklahoma and Illinois required the insurer to maintain reserves for unpaid and unresisted claims incurred under these disability provisions. The taxpayer maintained such reserves computed according to a standard method. They were established only for the policies under which the insured had sustained total and permanent disability, and the continuance of benefits was subject to termination either by death or recovery from disability. In its tax return, the insurer computed the mean of such reserve funds held at the beginning and end of the taxable year, and deducted three and three-fourths per centum thereof, which the commissioner disallowed.

Section 201 (a) of the Revenue Act of 1932 defines a life insurance company to be a company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which, held for the fulfillment of such contracts, comprised more than fifty per centum of its total reserve funds.

This question has been before the Board of Tax Appeals four times, and before the Court of Claims once.[1] Those portions of the law which are applicable to this case were originally enacted in 1921, and have been re-enacted in each succeeding revenue act, including that of 1939. The administrative interpretation, as evidenced by Treasury Regulation 62, Art. 681, promulgated in 1922, and unchanged in this aspect until 1935, provided that reserves

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[1]. Equitable Life Assurance Society v. Commissioner, 33 B.T.A. 708; Monarch Life Ins. Co. v. Commissioner, 38 B. T. A. 716; Pan American Life Ins. Co. v. Commissioner, supra; Oregon Mutual Life Ins. Co. v. Commissioner (Jan. 4, 1939); New World Life Ins. Co. v. U. S., 26 Fed. Supp. 444.

for amounts incurred but not due for total and permanent disability benefits were considered reserves as contemplated by the law. No life insurance company's right to the deduction was ever protested until 1934, when, after the decision of the Court of Claims in the case of *Continental Assurance Company* v. *United States*, 8 Fed. Supp. 474, the Commissioner concluded that such deductions should not be allowed. It will thus be seen that for thirteen years, including 1933, the administrative interpretation supported the taxpayer's contention. During this period, the Congress re-enacted the provisions without change, indicating that the administrative interpretation was not inconsistent with the legislative intent.[2] The attempt of the commissioner to apply 1935 treasury regulations to tax returns made for the year 1933 falls within the prohibition against retroactive application mentioned in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110.

Since the applicable provisions of the revenue act specifically define life insurance companies to include those issuing casualty contracts, and permit the reserve funds required by law held by such companies to be partially deductible, and since there is no express provision excluding casualty reserves from the coverage of the deduction, the most that can be said in favor of the construction urged upon us by the commissioner, in the light of the administrative interpretation, is that the statute is sufficiently ambiguous to give rise to a reasonable doubt as to its meaning, which we are required to resolve in favor of the taxpayer.[3]

The nature of the reserve in dispute is persuasive to the conclusion we have reached. Incurred disability reserves were created only after the disability had arisen. They were not fixed obligations. They were payable only in the future, and were contingent upon the continuance of both life and disability. Not being completely accrued, the extent of the probable liability thereunder was computed, and the amount of the reserve created was fixed, by tables of probability based upon approved rates of termination of such liability. The method of computation so

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[2]. U. S. v. Dakota-Montana Oil Co., 288 U. S. 459.

[3]. Old Colony Trust Company v. Commissioner, 284 U. S. 151; White v. Aronson, 302 U. S. 16.

employed is wholly consistent with that used for establishing amounts of premiums and reserves for ordinary life-insurance and annuity contracts, and is wholly inconsistent with reserves created to defray accrued and definite liabilities payable in the future. This is the distinguishing feature between the case at bar and those relied upon by the commissioner, which dealt with the reserves for the payment of accrued obligations for fixed amounts created by contract. The latter are mere solvency reserves having no relation to true insurance risks.[4]

The purpose of Congress in allowing these deductions is obvious. By the provision enacted in 1921, life insurance companies for the first time were taxed upon their investment income only, and no deduction was allowed for claims paid to policy holders or for net additions made to reserve funds, as insurance companies classed "other than life" were permitted by the act to do. Apparently, Congress recognized that life insurance companies were required by law to maintain numerous reserves comprising a large proportion of their total assets. Being thus deprived of potential investment returns, and being required to credit such reserves with compound interest annually, the deduction was allowed as a necessary compensation for earnings foregone by compliance with the law.[5] Due to its classification for income tax purposes as a life insurance company, the taxpayer is denied the right to claim the deductions on its casualty reserves to which casualty companies are entitled. Therefore, to deny it the deduction here claimed would have the unjust effect of declaring these reserves to be under the law for the penalties imposed by it, and outside the law for the benefits flowing from it.

A further inconsistency in the position we are urged to take is evidenced by the provisions of Section 203 (a) (2) of the Revenue Act of 1932, which expressly permits percentage deductions upon casualty reserves held by life insurance companies on certain types of policies, even though not required by law. It is unreasonable to believe

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[4]. McCoach v. Insurance Company of North America, 244 U. S. 585; United States v. Boston Insurance Company, 269 U. S. 197; Helvering v. Inter-Mountain Life Insurance Company, 294 U. S. 686; Helvering v. Illinois Insurance Company, 299 U. S. 88.

[5] Cf. Mass. Mutual Life Ins. Co. v. U. S., 56 F. (2) 897.

that Congress would discriminate between companies doing the same kind of casualty business, as the interpretation would require, when the conclusion we have reached is entirely in harmony with the theory of equal benefits. Our conclusion is that the reserve for incurred disability benefits held by the taxpayer was a fund required by law within the meaning of the statute.

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The decision of the Board of Tax Appeals in each instance is

AFFIRMED.
OAKLEY F. DODD, Clerk,

A True Copy:
Teste:

By E VENDLING Deputy
Clerk of the United States Circuit Court of
(Seal) Appeals for the Fifth Circuit.

No. 2. NEW WORLD LIFE INSURANCE CO. *v.* UNITED STATES. Certiorari, 310 U. S. 654, to the Court of Claims. Argued November 18, 19, 1940. Decided December 9, 1940. *Per Curiam:* The judgment is affirmed upon the first ground set forth in the opinion of the Court of Claims with respect to investment expenses, the views expressed on the second question considered by the Court of Claims as to the right of deduction on account of insurance reserves not being an essential basis for the judgment and being contrary to *Helvering* v. *Oregon Mutual Life Insurance Co.*, *ante*, p. 267. *Mr. William Marshall Bullitt*, with whom *Mr. Walter E. Barton* was on the brief, for petitioner. *Mr. Arnold Raum*, with whom *Solicitor General Biddle*, *Assistant Attorney General Clark*, and *Messrs. Sewall Key*, *J. Louis Monarch*, and *Guy Patten* were on the brief, for the United States. Reported below: 88 Ct. Cls. 405; 26 F. Supp. 444.